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No. ——

In the Supreme Court of the United States

PAUL HUDSON, *ET AL.*,
Petitioners,

v.

AEP TEXAS NORTH COMPANY, *ET AL.*,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTION PRESENTED

In *Entergy Louisiana, Inc. v. Louisiana Public Service Commission*, 539 U.S. 39 (2003), the Court reserved the question whether States are preempted from deciding that a utility violated its Federal Energy Regulatory Commission (FERC) tariff. As *Entergy* recognized, the filed-rate doctrine requires States to give effect to federal tariffs when setting retail rates. When disputes over the meaning of FERC tariffs arise in retail rate proceedings, are States preempted from interpreting those tariffs to ensure that the filed rate is used?

PARTIES TO THE PROCEEDING

Petitioners are Paul Hudson in his official capacity as the Chairman of the Public Utility Commission of Texas, Julie Parsley in her official capacity as Commissioner of the Public Utility Commission of Texas, and Barry Smitherman in his official capacity as Commissioner of the Public Utility Commission of Texas.

Respondents are AEP Texas North Company; the Cities of Abilene, Ballinger, Cisco, San Angelo, and Vernon, Texas; and Texas Industrial Energy Consumers.

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PETITION FOR WRIT OF CERTIORARI

This case raises the question that the Court expressly reserved in *Entergy Louisiana, Inc. v. Louisiana Public Service Commission*, 539 U.S. 39 (2003): whether federal law preempts a State from deciding that a utility's implementation of a FERC-filed tariff violates the terms of that tariff. The answer to this question involves the interplay of federal and state authority in the regulation of electric rates. It is beyond question that the right to establish reasonable interstate wholesale rates lies exclusively with the federal government. *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354, 374 (1988). Conversely, authority over retail rates has been reserved to the States. *Id.* at 373 (recognizing "undoubted" state jurisdiction over retail rates). States must

allow recovery of the wholesale rates mandated by the federal tariff when setting retail rates. *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 965 (1986). This requirement is embodied in the filed-rate doctrine, whose basic principle is that the rate on file with FERC is the only lawful rate that may be charged. *Montana-Dakota Utils. Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246, 251-252 (1951). This doctrine applies not only to rates per se, but also to allocations among utilities in an interstate utility system. *Nantahala*, 476 U.S. at 966. Thus, "FERC-mandated allocations of power are binding on the States, and States must treat those allocations as fair and reasonable when determining retail rates." *Mississippi Power*, 487 U.S. at 371.

The issue in this case is whether a State can, in the context of a retail rate-making proceeding, decide a contested issue as to the amount that is due under the FERC tariff, or whether only FERC may resolve any such dispute. The court of appeals held that the State was preempted from construing the tariff until FERC had considered and resolved the issue. This holding contravenes the Court's prior decisions on the filed-rate doctrine and threatens the authority of States to effect timely rate relief. The Court should grant the petition to answer the question left open in *Entergy* and to clarify that FERC's exclusive jurisdiction to establish rates does not preempt States from construing those FERC-filed tariffs so that the filed rate may be recovered in retail rates.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1- 9) is reported at 473 F.3d 581 (5th Cir. 2006). The court of appeals' denial of the petition for panel rehearing and rehearing en banc (Pet. App. 25-26) is unreported. The district court's Memorandum Opinion and Order (Pet. App.10-22) is reported

at 389 F. Supp.2d 759 (W.D. Tex. 2005), and the final judgment (Pet. App. 23-24) is unreported.

JURISDICTION

The judgment of the court of appeals was entered on December 21, 2006. The order of the court of appeals denying the petitions for panel rehearing and rehearing en banc was entered on January 26, 2007. Pet. App. 25-26. Petitioners invoke the Court's jurisdiction under 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISION INVOLVED

The Supremacy Clause of United States Constitution, Article VI, clause 2, provides:

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

STATEMENT

AEP Texas North Company (TNC) is a subsidiary of American Electric Power Company (AEP) and serves retail customers in northern and western Texas subject to the jurisdiction of the Public Utility Commission of Texas (PUCT). As required by Texas law, TNC commenced a proceeding at the PUCT to reconcile its past fuel expenses and revenues. The PUCT was to use any resulting under-recovered balance to establish a charge to be paid by customers in TNC's service area. Part of the fuel expense that TNC claimed was the cost of power purchased from third-party utilities. Under PUCT

regulations, utilities must offset such purchased-power expenses with revenues that they earn from wholesale power sales. 16 Tex. Admin. Code § 25.236(a)(7)(C).

As a subsidiary of AEP, TNC's income from such off-system sales is determined in part by a FERC-approved tariff called the System Integration Agreement (SIA). The SIA provides, among other things, that profits from certain off-system sales are to be divided between the companies in AEP's two operating regions—the AEP West and the AEP East—according to a specific formula. Once allocated between the regions, the margins are further subdivided among the various subsidiaries in each region according to other tariffs. The SIA formula allocates the margins between regions based in part on margins each region produced in prior years. Significantly, the SIA defines those margins as the "revenues collected" for each sale less the costs incurred in conducting the sale.

In the PUCT proceedings, ratepayer groups challenged the amount of off-system sale margins that TNC claimed under the SIA, arguing that the utility had acted contrary to the tariff by including in the tally of "revenues collected" the market value of open transactions—sales in which no revenues had yet been collected. This resulted in a greater share of margins allocated to AEP East. And AEP was not required to share margins with all of its customers in AEP East as it was for the Texas utilities in AEP West. Thus, AEP benefitted by including the uncollected, open transactions in its calculations of margins. Indeed, TNC stipulated that the effect of including the open-transaction values in the SIA profit calculations was to decrease the amount TNC shared with its ratepayers.

The PUCT ultimately agreed with the ratepayer groups that the federal tariff required TNC to include only those revenues

that had been collected. The PUCT's final order reduced TNC's final fuel balance to reflect the resulting obligation to share additional amounts with its ratepayers. Pet. App. 34.

TNC challenged the PUCT's order in federal district court, contending that the PUCT was prohibited from disagreeing with the utility's application of the SIA under the Court's opinion in *Entergy*. The district court exercised jurisdiction to consider TNC's claim of preemption under the Supremacy Clause of the United States Constitution (Art. VI., cl. 2) pursuant to 28 U.S.C. § 1331. The district court enjoined the Commissioners from enforcing the part of their order that credited TNC's retail ratepayers with the disputed amount. Pet. App. 24.

The court of appeals affirmed the judgment of the district court, holding that "FERC not the state, is the appropriate arbiter of any disputes involving a tariff's interpretation." Pet. App. 8.

REASONS FOR GRANTING THE PETITION

I. THIS CASE PRESENTS AN IMPORTANT ISSUE RESERVED BY THE COURT IN *ENTERGY*: WHETHER A STATE, IN SETTING RETAIL RATES, MAY DECIDE A DISPUTE ABOUT THE MEANING OF A TARIFF FILED WITH THE FEDERAL ENERGY REGULATORY COMMISSION.

This case presents a clean set of facts upon which to resolve the question left open in *Entergy*. Because the great majority of States are affected by this question, and because the court of appeals has adopted a rule that alters long-standing practices, this question warrants immediate clarification.

A. In *Entergy*, the Court Reserved the Issue of State Authority to Interpret Federally Filed Tariffs.

The primary issue decided in *Entergy* was whether Louisiana was preempted from finding that the utility had acted imprudently when the federal tariff delegated discretion to the utility to determine a matter affecting an interstate cost allocation. 539 U.S. at 41-42. The Court held that when a tariff filed with FERC authorizes an interstate utility to decide a specific matter that affects the allocation of costs among the utility's state-jurisdictional affiliates, States may not second guess the prudence of the utility's decision in setting retail rates. 539 U.S. at 50.

Louisiana also argued that, even if it could not consider the prudence of the utility's decision, it *could* find that the utility violated the relevant tariff provisions. *Id.* The Court concluded, however, that the point could not be reached because the Louisiana commission had not found a violation of the tariff in its order. *Id.* at 51 ("[T]he question before us is whether the LPSC's order is pre-empted under *Nantahala* and *MP&L*, and that order does not rest on a finding that the system agreement was violated."). The Court thus concluded that "we have no occasion to address the question of the exclusivity of FERC's jurisdiction to determine whether and when a filed rate has been violated." *Id.*

B. The Court of Appeals Decided the Question Reserved in *Entergy*.

This case presents the question that the Court did not reach in *Entergy*. In reviewing the expenses TNC claimed, the PUCT construed the FERC-filed SIA and determined that TNC had not complied with the tariff. Rather than accepting TNC's interpretation, the PUCT applied what it determined to be the correct allocation under the SIA's formula. The courts below,

relying on *Entergy*, found that the PUCT was preempted from interpreting the FERC-filed tariff and held that only FERC can determine whether the tariff has been violated. Pet. App. 9.

C. A Decision About Interstate Allocations Among Electric Utilities Has Broad Impact.

Whether States may construe federal tariffs is a matter of fundamental importance that needs to be decided. Allocative tariffs like the SIA control significant quantities of costs and revenues shared among state-jurisdictional utilities throughout the country. Forty-two of the forty-eight contiguous States are served by subsidiaries of interstate public-utility holding companies.[1] AEP alone serves more than five million customers in eleven States.[2] When a parent company incurs costs that cannot be attributed to any one subsidiary, it must distribute those costs among its subordinates. Because of their interstate impact, those costs are often allocated pursuant to FERC-approved tariffs.

D. State Retail Rate-Making Proceedings Must Address These Allocated Costs and Revenues.

As the Court has recognized, "the cost allocation between operating companies is crucial to the setting of retail rates." *Entergy*, 539 U.S. at 42. In proceedings to change retail utility rates, States must decide whether the utility has properly accounted for all costs and revenues, including those claimed under FERC-established allocations. Rate cases are generally

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1. Michael Murphy, National Regulatory Research Institute, Holding Companies Registered under PUHCA and Their Regulated Utility Subsidiaries, 2-6 (Oct. 2005), *available at* http://www.nrri.ohio-state.edu/dspace/bitstream/2068/807/1/05-15.pdf.

2. *See* AEP: About Us, http://www.aep.com/about/default.htm (last visited Apr. 23, 2007).

substantial undertakings involving significant state resources and large sums of money. As one would expect, ratepayer groups and regulated utilities frequently disagree on any number of matters. Yet the Fifth Circuit has held that, when "any dispute" arises as to the proper construction of a FERC tariff, States may not decide the dispute. Pet. App. 9. Instead, States in the Fifth Circuit must abate their rate proceedings and file a request with FERC to have the contested issue resolved—no matter how insignificant the dispute or unfounded the position.

E. The Court of Appeals' Decision—That All Disputes About FERC Tariffs Must Be Referred to FERC—Adversely Impacts State and Federal Regulation.

Automatically sending all such disputes to FERC would substantially impede both state and federal regulatory efforts. Requiring States to halt retail rate proceedings to seek FERC resolution of any disagreement would likely result in an additional delay of months, if not years, before new retail rates

could be set.[3] FERC, moreover, would be tasked with the expanded caseload attributable to challenged tariff interpretations even though FERC itself has recognized that not all actions to enforce a FERC tariff require the exercise of FERC jurisdiction. *See City of Glendale, Cal. v. Portland General Electric Co.*, 115 FERC ¶ 61231, 61848 (2006); *Kentucky Utils. Co.*, 110 FERC ¶ 61285, 62102-03 (2005).

Moreover, if utilities adopt erroneous interpretations of their own tariffs, States might acquiesce in those interpretations rather than face the delays accompanying federal review. In this way, a primary purpose of the filed-rate doctrine—to ensure that utilities are held to the rates on file with FERC—would be defeated. *See American Tel. & Tel. Co. v. Central Office Tel., Inc.*, 524 U.S. 214, 223 (1998).

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3. Although FERC does not maintain aggregate performance statistics, the delays accompanying FERC proceedings are well known. *See Anadarko Petroleum Corp. v. Federal Energy Regulatory Comm'n*, 196 F.3d 1264, 1268 (D.C. Cir. 1999) (noting "snail-like pace" of FERC proceedings). Indeed, FERC dockets referenced in this petition demonstrate this point. *See Entergy Services, Inc. and Gulf States Utils. Co.*, 80 FERC ¶ 61197 (1997) (taking three years and nine months to determine that Entergy violated system tariff by including mothballed units as); *City of Glendale, Cal. v. Portland Gen. Elec. Co.*, 115 FERC ¶ 61231 (2006) (taking over seven months to finally decide that FERC had no primary jurisdiction to consider dispute); *Kentucky Utils. Co.*, 110 FERC ¶ 61285 (2005) (taking over eight months to finally determine that FERC had no primary jurisdiction to consider dispute).

II. THE COURT SHOULD CLARIFY THAT STATE COMMISSIONS ARE NOT PREEMPTED FROM DETERMINING WHETHER A UTILITY COMPLIED WITH ITS FERC TARIFF.

A. FERC Is Not the Exclusive Venue for Deciding a Dispute About the Meaning of a Tariff.

Although only FERC may set interstate wholesale electric rates, other authorities may *construe* the tariff. The Court has long held that a state court can interpret a federal tariff to settle a dispute even though the State is preempted from setting the rate. In *Great Northern Railway Co. v. Merchants' Elevator Co.*, 259 U.S. 285 (1922), this Court recognized the difference between setting rates and construing the filed tariff. Merchants' Elevator Company had sued the railroad in state court, alleging that the railroad had not charged rates that complied with its tariff. The question was one of tariff construction: specifically, whether the rule in the tariff or the tariff's exception to the rule applied to the service provided. The railroad claimed that the trial court lacked jurisdiction over the suit until the Interstate Commerce Commission decided the proper construction of the tariff, but this Court disagreed and found that the state court could construe the tariff. In reaching this conclusion, the Court recognized a distinction between setting rates—a legislative function unique to the federal agency—and determining whether a tariff was violated in order to decide a contract dispute:

> To determine what rate, rule or practice shall be deemed reasonable for the future is a legislative or administrative function. . . . *But what construction shall be given to a railroad tariff presents ordinarily a question of law which does not differ in*

> *character from those presented when the construction of any other document is in dispute.*

259 U.S. at 291 (emphasis added). FERC itself has recognized that disputes over the meaning of FERC tariffs can be decided by state courts. *See City of Glendale, Cal. v. Portland General Elec. Co.*, 115 FERC ¶ 61231, 61847-48 (2006) (ruling that state court claim seeking only to enforce the filed rate, not to alter it, did not require exercise of FERC jurisdiction); *Kentucky Utils. Co.*, 110 FERC ¶ 61285, 62102-03 (2005) (holding that state court suit that "only seeks enforcement of an existing [FERC-filed] contract and not the setting of new just and reasonable rate . . . does not fall within the Commission's exclusive jurisdiction.").

Just as state courts may construe federal tariffs to perform their adjudicative roles, so should the PUCT be permitted to construe TNC's federal tariff to perform its regulatory function: setting retail rates that include the amounts due under the federally filed wholesale tariff.

The PUCT did not set wholesale electric rates; FERC set those rates when it approved the SIA. A formula in that tariff required computation of the revenues collected from off-system sales. The question the PUCT considered was whether interim estimates of the value of uncompleted transactions were "revenues collected." To set retail rates, the PUCT had to interpret the federal tariff; but the PUCT did not set interstate wholesale rates.

B. Preemption Is Not Necessary to Preserve Uniform Application of FERC-Filed Allocation Tariffs.

The Commissioners acknowledge the need for uniform application of interstate tariffs among the States. But this need does not overcome the PUCT's authority to construe the federal

tariff. The need for uniformity was claimed as a justification for preemption in *Great Northern* and *Pan American Petroleum Corp. v. Superior Court of Delaware*, 366 U.S. 656 (1961). In both cases, the Court recognized that the ultimate availability of resort to this Court was sufficient to ensure the needed uniformity. That same process can provide uniformity in this case. Both state and federal courts may review the PUCT's construction of a filed FERC tariff, and in either case, further appeal to this Court remains available.

Allowing States to interpret federal tariffs when interpretation is necessary for a state agency to set retail rates does not preclude resort to the federal agency in all cases. When the federal tariff cannot be interpreted without a policy determination by FERC, either the state agency or the reviewing court can refer the question to the federal agency, with the doctrine of primary jurisdiction providing a framework for determining when referral is necessary.

The Court distinguished between questions within a federal agency's exclusive jurisdiction and those subject to the doctrine of primary jurisdiction in *United States v. Western Pacific Railroad Co.*, 352 U.S. 59 (1956). There the Court was presented with claims both that the carrier had not complied with its tariff and that the tariff was unreasonable. Reasonableness of the tariff was a rate-setting question within the exclusive jurisdiction of the federal agency. *Id.* at 62-65. In addition, the Court found that one question of tariff compliance should have been referred by the Court of Claims to the Interstate Commerce Commission as a matter of primary jurisdiction. *Id.* at 63-65. Primary jurisdiction applies where a court has jurisdiction over a claim, but the court should nonetheless to refer some issue within the claim to a regulatory agency because the issue is within the agency's special competence. *Reiter v. Cooper*, 507 U.S. 258, 268 (1993).

Similarly, state commissions can ensure uniformity by deferring to FERC when appropriate as a court would under the doctrine of primary jurisdiction.[4] State commissions are capable of interpreting tariffs, and many instances of FERC tariff application are so straightforward that resort to the FERC is unnecessary. For example, in the *Nantahala* case, the federal agency had approved a tariff allocating 22.5% of low-cost hydroelectric power to the Nantahala utility. If the Court had followed the Fifth Circuit's present rule that any dispute requires FERC's exclusive attention, then North Carolina would

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4. As a recent example, the PUCT abated its proceeding to obtain a decision within the special competence of a regulatory agency in Tex. Pub. Util. Comm'n, *Petition by UTex Communications Corporation for Arbitration Pursuant to Section 252(b) of the Federal Telecommunications Act, and PURA for Rates, Terms, and Conditions of Interconnection Agreement with Southwestern Bell Telephone, L.P. d/b/a SBC Texas*, Docket 26381 (June 22, 2006) (Order Abating Proceeding). The PUCT opted to defer decision in an arbitration until the Federal Communications Commission decides whether certain services are information services subject to one set of statutes and rules or telecommunications services subject to a different set of statutes and rules. Other States have also referred issues to federal agencies with primary jurisdiction. *See, e.g.*, Idaho Pub. Util. Comm'n, *In the Matter of the Application of Pagedata for Approval of an Amendment to a Paging Interconnection Agreement with Qwest Corporation Pursuant to 47 U.S.C. § 252(e)*, Case NO QWE-T-03-6 (Oct. 6, 2004) (Order at 7) (Ordering issue within primary jurisdiction of FCC referred to that agency); Kansas Corp. Comm'n, *In the Matter of the Complaint of Seminole Energy Services Requesting a Commission Investigation of the Rates, Fees, and Practices of Atmos Energy and its Wholly Owned Affiliate, Woodward Marketing, LLC*, Docket No. 03-ATMG-965-COM (Jan. 16, 2004) (Order at 10-11) (Ordering issue within primary jurisdiction of FERC referred to that agency).

have been powerless to apply the approved 22.5% share if any party to the retail rate-making proceeding had argued that a different percentage was required under the tariff. Resort to the federal agency would have been necessary even though the appropriate allocation was hardly disputable. Under such facts, the only consequence of resort to FERC would be delaying the state retail rate proceedings and wasting FERC's resources. Some tariff disputes may raise policy questions that *do* require referral to FERC, but the court of appeals' decision that all disputes should be referred to FERC ignores the difference. Preemption is unnecessary to protect the federal interests at stake.

Unlike requiring preemption, applying the doctrine of primary jurisdiction would allow the States to decide those questions of tariff interpretation that are not within the special competence of the federal agency. And, just as a court's improper refusal to refer under the doctrine of primary jurisdiction can be overturned on appeal, a state agency's improper refusal to refer an issue within FERC's special competence could be reversed. In addition, a court reviewing the correctness of the State's interpretation of the federal tariff could, itself, refer the issue to FERC under the doctrine of primary jurisdiction.

C. The Court of Appeals Erroneously Found That the *Entergy* Line of Cases Answers the Question Presented.

The court of appeals' decision is not compelled by the line of cases in which this Court has found an encroachment by States on FERC's rate-setting authority. *See Mississippi Power*, 487 U.S. at 373 ("Once FERC sets such a rate, a State may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable."); *Nantahala*, 476 U.S. at

964 (holding that under the filed-rate doctrine a state court is preempted from deciding the reasonableness of a federal rate); *Entergy*, 539 U.S. at 49-50 (denying state authority to determine whether the utility prudently exercised discretion granted in a FERC tariff). Each of those cases involved a State conducting a prudence inquiry about allocations prescribed by a FERC tariff. In *Nantahala*, the North Carolina agency decided it was imprudent for the utility to be allocated less than 24.5% of the low-cost hydroelectric power. But the Federal Power Commission had already decided that 22.5% should be allocated to Nantahala. 476 U.S. at 958-60. In *Mississippi Power*, the Mississippi Supreme Court held that the Mississippi agency should determine whether the utility was prudent to acquire power from a nuclear power plant, even though FERC had already allocated a percentage of the electricity from that plant to the utility. 487 U.S. at 356. In *Entergy*, the Louisiana commission held that Entergy imprudently included mothballed units in wholesale rates. This Court noted that the FERC-approved tariff left "the classification of ERS units to the discretion of the [utility] operating committee." 539 U.S. at 49. Because the FERC tariff set out "how and by whom that classification should be made," *id.* at 50, the state agency, by assessing the prudence of Entergy's decision that certain plants were available, impermissibly challenged the reasonableness of FERC's tariff that granted the utility discretion to make that decision.

By considering the reasonableness of rates, States in *Nantahala*, *Mississippi Power*, and *Entergy* encroached on authority expressly granted by the Congress to FERC. Determining the prudence or reasonableness of expenses is a matter inherent to the setting of rates. *Appalachian Power Co. v. Pub. Serv. Comm'n of W. Va.*, 812 F.2d 898, 905 (4th Cir. 1987) ("[T]he prudence inquiry is inseparable from an inquiry

into [the rate's] justness and reasonableness."). Only FERC can determine whether interstate wholesale rates are just and reasonable. *See Montana-Dakota*, 341 U.S. at 251 (explaining the difference between the reasonableness decisions made by courts and the reasonableness decisions made by agencies in the process of setting rates).

Here, the PUCT does not dispute that it is preempted from deciding the justness or reasonableness of the allocation in the SIA. *See Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 581 (1981). Rather, the PUCT is simply requiring TNC to comply with the tariff set by FERC in approving the SIA. As recognized in *Great Northern*, requiring compliance with a tariff is distinct from setting rates. 259 U.S. at 291. Indeed, for that reason both federal courts and federal agencies are authorized to enforce a tariff. *See* 16 U.S.C. § 825e (allowing FERC to investigate whether a utility has violated a FERC order); 16 U.S.C. § 825p (allowing a suit to enforce compliance with a FERC tariff).

The question of the correct construction of a tariff is not limited to an action to enforce the tariff at FERC or in a federal district court under the Federal Power Act. *Pan American* shows that a tariff-construction question may arise in the context of a lawsuit, and that such a lawsuit may be brought in state court. *See* 366 U.S. at 664-65. Similarly, a dispute about the meaning of a federal tariff may arise in the context of a retail rate case and be decided by the state agency.

Both the utility and the State are bound by the filed rate. This Court has held that "the right to a reasonable rate is the right to the rate which the [FERC] files or fixes . . . ." *Montana-Dakota*, 341 U.S. at 251. The SIA conclusively and exclusively states the rights and liabilities of a utility. *See California ex rel. Lockyer v. Dynegy, Inc.*, 375 F.3d 831, 853

(9th Cir. 2004) ("Under the filed rate doctrine, the terms of the filed tariff are considered to be the law and to therefore, conclusively and exclusively enumerate the rights and liabilities of the contracting parties." [internal quotes omitted]). Thus, the PUCT was obligated by federal law to include the amounts set by TNC's federally filed tariff. To comply with that law, the PUCT had to construe the SIA.

TNC is also obligated to charge only the filed rate. *Id.* The utility cannot avoid that obligation by charging something other than the filed rate and then claiming that costs would be illegally trapped if the utility could only recover the filed rate through its retail rates.

Additionally, TNC cannot escape its duty to comply with the federally filed tariff by claiming it was granted *Entergy*-type discretion. *Entergy* did not hold that a utility always has discretion to determine the amount of its filed rate. The utility's discretion in that case rested on the wording of the FERC-approved tariff. Entergy's tariff allowed a mothballed generator to be treated as available, and, therefore, included in rates "if the [utility] operating committee determines it intends to return the unit to service at a future date." *Entergy*, 539 U.S. at 44. Thus, the FERC-filed tariff made the utility committee's intent the critical factor in determining whether a generator was included in rates.

But *Entergy* did not shift all discretion to set wholesale electric rates to the utility. When a FERC-filed tariff requires a certain action, the utility is bound by that tariff requirement. The company cannot claim that the mere duty under the tariff to perform a calculation constitutes discretion to decide the rate. The railroad in *Great Northern* was required to implement its tariff, but that obligation did not amount to delegating discretion to the utility to determine which rule applied.

Likewise, the fact that the SIA requires the utility to make certain calculations does not in any sense constitute a grant of discretion to determine how the allocation should be made.

In sum, States are not preempted from interpreting FERC tariffs. The State must include any and all FERC-authorized wholesale expenses when setting retail rates. In most cases, the State can easily determine whether the amounts claimed comply with the tariff. But if the interpretation of the tariff requires exercise of FERC discretion, a State can seek clarification from FERC as States have done in the past. In the event that a State proceeds without seeking necessary FERC review, that decision could be reversed. But the court of appeals' rule of preemption barring States from simply considering the tariff's meaning is not compelled by law and is unnecessary.

CONCLUSION

The Court should grant the petition for writ of certiorari.

Respectfully submitted,

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April 2007

(2) Supreme Court, U.S.
FILED
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No. ——

In the Supreme Court of the United States

PAUL HUDSON, *ET AL.*,
Petitioners,

v.

AEP TEXAS NORTH COMPANY, *ET AL.*,
Respondents.

On Petition for Writ of Certiorari to the
United States Court of Appeals for the Fifth Circuit

APPENDIX TO PETITION FOR WRIT OF CERTIORARI

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REVISED JANUARY 16, 2007

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

United States Court of Appeals
Fifth Circuit
FILED
December 21, 2006
Charles R. Fulbruge III
Clerk

No. 05-51755

AEP TEXAS NORTH CO.,

Plaintiff-Appellee,

versus

TEXAS INDUSTRIAL ENERGY CONSUMERS,

Intervenor-Defendant,

versus

CITIES OF ABILENE, BALLINGER, CISCO, SAN ANGELO AND VERNON, TEXAS,

Intervenor-Defendants
-Appellants,

versus

THE PUBLIC UTILITY COMMISSION OF TEXAS, ET AL.,

Defendants,

PAUL HUDSON, CHAIRMAN OF THE PUBLIC UTILITY COMMISSION OF TEXAS; JULIE PARSLEY, COMMISSIONER OF THE PUBLIC UTILITY COMMISSION OF TEXAS; and BARRY T. SMITHERMAN, COMMISSIONER OF THE PUBLIC UTILITY COMMISSION OF TEXAS,

Defendants-Appellants.

Appeals from the United States District Court
for the Western District of Texas
(USDC No. 1:04-CV-1069)

Before REAVLEY, STEWART and CLEMENT, Circuit Judges. REAVLEY, Circuit Judge:

The issue before us is whether a state regulatory agency may set retail rates based on its own determination that a utility has not complied with a Federal Energy Regulatory Commission ("FERC") tariff. We hold that pursuant to the filed rate doctrine, federal law preempts state regulators from making a final determination as to whether a FERC tariff has been violated and from imposing a remedy for an alleged violation. We therefore affirm.

I.

A. The Merger

Appellee Texas North Company ("TNC") provides retail electric service solely in Texas. In 1999, TNC's parent, the Central and South West Company, merged with the American Electric Power Company ("AEP"). TNC is now one of nine public utilities owned by AEP.

Before the merger, AEP submitted a merger plan, termed the System Integration Agreement (the "SIA"), for approval to FERC. FERC approved the plan. The SIA is the tariff, or rate schedule, currently filed with FERC.

When the AEP system has an excess of generating capacity, an affiliate of the utilities, called the AEP Service Corporation ("AEPSC") sells the excess power at wholesale. The SIA requires that AEPSC determine the profits from such sales, called Trading and Marketing Realizations ("TMRs"), "on an hourly basis." The SIA defines TMRs as "the difference between i) the revenues collected from Trading and Marketing Activities and ii) the Out-of-Pocket Cost of such Trading and Marketing Activities and any transmission cost related to such activities."

The SIA then mandates that from sales made by all, AEPSC will distribute the TMRs between two zones in the AEP system,

according to a specific formula. The distribution occurs in two stages. First, the SIA provides that all TMRs up to a certain amount (equaling the amount of TMRs that were recorded in a Base Year, the twelve month period preceding the merger) will be allocated between the former Central and South West company (now called AEP West) and the former AEP company (now called AEP East) as they were in the Base Year. This first allocation favors AEP East. Second, all remaining TMRs are allocated between AEP East and AEP West in proportion to generating capacity. This allocation favors AEP West. Therefore, TNC is favored in the second stage of the allocation process.

B. The Commission's Review

Immediately before Texas moved to a deregulated electricity market in 2002, the Texas Legislature mandated that the successors of the former public utilities seek a final reconciliation of their regulated fuel expenses and revenues before the Public Utility Commission of Texas (the "Commissioners"). According to Texas law, after costs and revenues are reconciled, the utilities must refund any over-recovery to the utility's retail ratepayers. 16 Tex. Admin. Code Ann. § 25.236(e) (2002). TNC filed a petition for a final reconciliation in June 2002.

In the first proceeding related to this appeal, the Commissioners found that the TMR allocations were correctly calculated pursuant to the SIA. On rehearing, however, the Commissioners disagreed with AEPSC's calculation of TMRs in the Base Year. AEPSC credited the AEP East companies with the values of "open" transactions that had not yet been completed, as well as the profits from completed sales. The Commissioners determined that including the "open" transactions (a method of accounting known as

"mark-to-market") in the Base Year calculations was not consistent with the SIA, which defined TMRs as the difference between revenues collected and out-of-pocket costs.

The Commissioners then proceeded to rectify the alleged error in calculations. The parties in the reconciliation proceeding stipulated that the mark-to-market accounting resulted in $7.9 million less in revenues for TNC. The Commissioners ordered that TNC reduce its retail rates as if it had received this revenue. However, AEPSC did not change its method of calculating TMRs. Because of the lower retail rates, TNC was forced to absorb the difference between the actual allocation of revenues and the lower retail rates. TNC filed a motion for rehearing, which was overruled.

TNC filed this action in federal court, challenging the order on preemption grounds. The district court granted TNC's motion for summary judgment, finding that the Commissioners' ruling violated the Federal Power Act and the Supremacy Clause of the U.S. Constitution.

II.

A.

The Federal Power Act ("FPA") gives FERC exclusive jurisdiction to regulate the transmission and wholesale sale of electric energy in interstate commerce.[1] The filed rate doctrine, which governs this case, derives from that jurisdictional grant. "The filed rate doctrine requires 'that interstate power rates filed with FERC or fixed by FERC must be given binding effect

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1. 16 U.S.C. § 824(b)(1).

by state utility commissions determining intrastate rates.' "[2] The FPA and the Supremacy Clause, U.S. Const. art. VI, § 2, preempt any state action modifying or overruling a filed rate.[3] Pursuant to the doctrine, the Supreme Court has determined that federal law preempts states from second-guessing FERC's allocations of electric power[4] and from conducting prudence inquiries into FERC's cost allocations, even when FERC has not conducted such an inquiry.[5] In addition, states are prohibited from "trapping costs" by setting retail sales at a level that would prevent a utility "from recovering the costs of paying the FERC-approved rate."[6]

In *Entergy*, the most recent Supreme Court case dealing with the filed rate doctrine, the Court considered "whether a FERC tariff that delegates discretion to the regulated entity to determine [a] precise cost allocation ... preempts a [state commission's] order that adjudges those costs imprudent."[7] The Entergy Corporation owned five different public utilities, which could use each other's excess capacity. The costs of keeping

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2. *Entergy Louisiana, Inc. v. Louisiana Pub. Serv. Comm'n*, 539 U.S. 39, 47, 123 S.Ct. 2050, 2056 (2003) ("*Entergy*") (quoting *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 962, 106 S.Ct. 2349, 2354 (1986)).

3. *Entergy*, 539 U.S. at 47, 123 S.Ct. at 2056.

4. *Nantahala*, 476 U.S. at 955, 106 S.Ct. at 2351.

5. *Mississippi Power & Light Co. v. Moore*, 487 U.S. 354, 357, 108 S.Ct. 2428, 2431 (1988).

6. *Nantahala*, 476 U.S. at 970, 106 S.Ct. at 2358-59.

7. *Entergy*, 539 U.S. at 42, 123 S.Ct. at 2053.

excess capacity available were shared among the utilities according to a provision in a system agreement, filed with FERC, that Entergy's operating committee administered. The provision at issue was an automatic adjustment clause, which under § 205(f) of the FPA allows for increases or decreases in a utility's paid costs without prior hearings.[8] In determining costs, the operating committee designated certain generating units (called Extended Reserve Shutdown, or ERS, units) as "available" when those units were actually shut down, but could be activated in emergencies.[9] This designation caused Entergy Louisiana, Inc., a utility with ERS units, to pay a higher percentage of costs. The Louisiana Public Service Commission found that although it was preempted from determining whether the system agreement was violated, it could determine that Entergy's expenditures were imprudent because Entergy paid more for possessing ERS units.[10] Thus, the Louisiana Commission did not allow Entergy to increase retail rates to cover those costs.[11]

The Supreme Court reversed, holding that the Commission's prudence inquiry was preempted even though the proper classification of ERS units was not pursuant to a specific mandate from FERC, but instead was within the discretion of

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8. *Id.* at 42-43, 123 S.Ct. at 2053-54.

9. *Id.* at 43, 123 S.Ct. at 2054.

10. The Louisiana Public Service Commission looked only at the time period after August 5, 1997, as FERC had already found that categorizing the ERS units as "available" was reasonable prior to August 5, 1997. *Id.* at 44, 123 S.Ct. at 2054.

11. *Id.* at 45, 123 S.Ct. at 2055.

the operating committee.[12] The Court found that the Commission's order impermissibly "trapped costs" by failing to allow Entergy to recoup the costs of paying for the ERS units.[13]

B.

Here, we also consider a tariff which designates an agent to perform an allocation (although *Entergy* involved an allocation of costs, rather than revenues). Appellants argue that the instant case can be distinguished from *Entergy* because in this case, AEPSC's interpretation of the formula violated the language of the filed tariff, an issue which was not before the Court in *Entergy*.[14] They contend that the Commissioners' order correctly interpreted the tariff, and therefore fulfilled the state's obligation to implement the filed rate.

Although Appellants argue the Commissioners' order implemented the filed rate, the entire SIA, not simply the formula in question, is filed with FERC. "[T]he filed rate doctrine is not limited to 'rates' *per se*."[15] The states are bound to implement a FERC-approved agreement, and the agreement

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12. *Id.* at 49-50, 123 S.Ct. at 2057 ("We see no reason to create an exception to the filed rate doctrine for tariffs of this type that would substantially limit FERC's flexibility in approving cost allocation arrangements.").

13. *Entergy*, 539 U.S. at 49, 123 S.Ct. at 2056.

14. *Id.* at 50-51, 123 S.Ct. at 2058.

15. *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 966, 106 S.Ct. 2349, 2357 (1986). *See also Entergy*, 539 U.S. at 50, 123 S.Ct. at 2056 ("It matters . . . only whether the FERC tariff dictates how and by whom [the] classification should be made.").

authorizes only AEPSC to implement the formula.[16]

Furthermore, FERC not the state, is the appropriate arbiter of any disputes involving a tariff's interpretation.[17] Congress has given FERC exclusive jurisdiction to determine whether wholesale rates are just and reasonable.[18] Additionally, it is FERC's duty under the FPA to make an assessment of the broad public interests involved in determining interstate rates.[19] If each state could enforce its own findings as to the meaning of a filed tariff, in opposition to the conclusions of a FERC-approved agent, the conflicting interpretations would undermine FERC's ability to ensure that a filed rate is uniform across different states, and intrude upon its exclusive

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16. *See Mississippi Power & Light Co. v. Moore*, 487 U.S. 354, 374, 108 S.Ct. 2428, 2440 (1988) ("States may not regulate in areas where FERC has properly exercised its jurisdiction . . . to insure that agreements affecting wholesale rates are reasonable.").

17. *See id.* at 2442-43 (1988) (Scalia, J., concurring) ("[W]hether one characterizes the questions as related to prudence, interpretation [of the basic system agreements], or cost allocation, they are clearly matters most appropriately resolved by the Commission as part of its overriding authority to evaluate and implement all applicable wholesale rate schedules.") (quoting *AEP Generating Co.*, 36 FERC ¶ 61,226 (1986)).

18. 16 U.S.C. §§ 824d, 824e. *See also Mississippi Power*, 487 U.S. at 377, 108 S.Ct. at 2442 (Scalia, J., concurring) ("It is common ground that if FERC has jurisdiction over a subject, the States cannot have jurisdiction over the same subject.").

19. *See* 16 U.S.C. § 824(a).

jurisdiction over interstate power transactions.[20] Therefore, it is within FERC's jurisdiction, not the states', to make a final determination as to whether the tariff has been violated. If a state disputes a utility's interpretation of a tariff, FERC is the proper forum for resolving the disagreement.[21]

Finally, the FPA gives FERC exclusive jurisdiction to remedy tariff violations by providing refunds.[22] If states could remedy perceived violations by setting retail rates based on their own calculations, states could potentially "trap" costs by prohibiting the utility from passing on the price of FERC-mandated rates to consumers.[23] Thus, the filed rate doctrine requires that the states use AEPSC's calculations to set retail rates until FERC resolves any dispute over the tariff's interpretation.

III.

We find that the Commission's actions were preempted by the Supremacy Clause and the Federal Power Act.

AFFIRMED.

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20. *See Appalachian Power Co. v. Public Service Comm'n of West Virginia,* 812 F.2d 898, 905 (4th Cir.1987).

21. *Cf. Mississippi Power,* 487 U.S. at 375, 108 S.Ct. at 2441 (finding that the "only appropriate forum" for determining the reasonableness of filed rates and agreements "is before the Commission or a court reviewing the Commission's order.").

22. *See* 16 U.S.C. § 824e.

23. *See Mississippi Power,* 487 U.S. at 372, 108 S.Ct. at 2439. Appellants claim that in this case, no costs were "trapped" because the formula at issue involved the allocation of revenue, not costs. Nonetheless, the result was the same: the utility lost money.

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

AEP TEXAS NORTH COMPANY,	§	CAUSE No.
PLAINTIFF,	§	
	§	
V.	§	A-04-CA-1069-LY
	§	
PAUL HUDSON, CHAIRMAN OF THE PUBLIC UTILITY COMMISSION OF TEXAS, JULIE PARSLEY, COMMISSIONER OF THE PUBLIC UTILITY COMMISSION OF TEXAS, AND BARRY SMITHERMAN, COMMISSIONER OF THE PUBLIC UTILITY COMMISSION OF TEXAS,	§	
DEFENDANTS.	§	

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MEMORANDUM OPINION AND ORDER

Before the Court are Plaintiff AEP Texas North Company's Motion for Summary Judgment and Memorandum of Law in Support filed February 23, 2005 (Doc. ## 11, 12); Plaintiff's Statement of Material Facts filed February 23, 2005 (Doc. # 13); Commissioners' Response to Plaintiff's Statement of Material Facts filed April 1, 2005 (Doc. # 25); Commissioners' Response and Cross-Motion for Summary Judgment filed April 1, 2005 (Doc. ## 26, 27); Intervenor Cities' Response to Plaintiff's Motion for Summary Judgment filed April 1, 2005 (Doc. # 29); Plaintiff's Reply in Support of Summary Judgment

and Opposition to Cross-Motion for Summary Judgment filed April 12, 2005 (Doc. ## 32, 33); Commissioners' Supplemental Brief in Support of Judgment filed May 27, 2005 (Doc. # 41); Intervenor Cities' letter brief filed May 27, 2005 (Doc. # 42); and Plaintiff's Response to Defendants' Supplemental Brief filed June 7, 2005 (Doc. # 43). On June 21, 2005, this Court held a hearing on the above-listed motions. Plaintiff AEP Texas North Company ("AEP Texas") appeared by counsel; Defendants the individual Commissioners (hereinafter referred to collectively as the "Commissioners") appeared by counsel; and Intervenors the Cities of Abilene, Ballinger, Cisco, San Angelo, and Vernon, Texas appeared by counsel. Having carefully considered the motions, responses, replies, along with the summary-judgment evidence in the Texas Public Utility Commission ("PUC") record and the case law applicable to this action, this Court concludes that summary judgment should be granted in favor of AEP Texas, and that the Commissioners' cross-motion for summary judgment should be denied for the reasons set forth below.

I. Background

AEP Texas is a wholly owned subsidiary of American Electric Power Company ("AEPC"), a multistate electric-utility holding company. AEPC's subsidiary companies provide electrical service to approximately five million customers in parts of eleven states. This cause involves a System Integration Agreement ("SIA") among nine of AEPC's operating companies that provides for an agent-the American Electric Power Service Corporation ("AEPSC")-to allocate "Trading and Marketing Realizations" that the AEPC system earns from a category of wholesale-electricity market transactions. The SIA is a wholesale rate schedule on file with the Federal Energy Regulatory Commission ("FERC").

AEP Texas is a party to the SIA. The SIA provides the contractual basis for the distribution of certain power supply costs and benefits between two zones of AEPC, the east zone and the west zone, corresponding to the premerger systems of AEPC and Central and South West Corporation ("CSW"), two public utility holding companies.[1] As a wholly owned subsidiary of AEPC, AEP Texas is also required to share revenues with its retail customers under the SIA.

On June 3, 2002, AEP Texas applied to the PUC to reconcile its fuel expenses and revenues for the period of July 1, 2000, through December 31, 2001. One issue before the PUC involved the amount of revenue that AEP Texas was required to share with its customers under the terms of the SIA and the Integrated Stipulation and Agreement approved by the Commissioners following the merger of AEPC and CSW. The service schedule at issue is Service Schedule D, which allocates the Trading and Market Realizations ("TMRs") on the system. The SIA provides that the TMRs, or profits, from off-system sales and purchases of power, energy, or capacity are to be allocated between the AEP east and west zones. Section 1.39 of the SIA defines TMRs as "the difference between (i) revenues collected from Trading and Marketing activities and (ii) the Out-of-Pocket Cost of such Trading and Marketing activities and any transmission cost related to such activities."

The SIA designates AEPSC to centrally calculate the TMRs. The SIA also sets forth a process for making such allocations. In the first stage, realizations are allocated such that the AEPC east and west zones receive the same amount of realizations as they did in the "Base Year" (July 1999 through

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1. The merged entity took the name "American Electric Power Company."

June 2000). In the second stage, all profits above the amount earned during the Base Year are divided between the AEPC east and west zones according to their relative ownership of generating capacity. Once the TMRs have been allocated between the AEPC east and west zones, and AEP Texas receives its portion, the SIA specifies how AEP Texas is to share its revenue with its retail customers.

As part of its review of AEP Texas's application to reconcile fuel expenses and revenues, the Commissioners examined AEPSC's allocation of TMRs under the terms of the SIA. In calculating the realizations for the Base Year, AEPSC used "mark to market" accounting in which the "open" transactions, or transactions that had yet to be completed, were recorded at market value, while "closed" or completed transactions were recorded at the actual contract value. Both open and closed transactions were included in the level of realizations achieved in the Base Year. Thus, AEPSC's proposed Base Year allocation of TMRs included both open and closed transactions.

The Commissioners disagreed with AEPSC's allocation under the SIA, determining that AEPSC improperly included TMRs resulting from open transactions in the Base Year allocation. The Commissioners required AEP Texas to recalculate the TMR allocation to exclude all open transactions, resulting in a higher share of TMRs for the AEPC west zone and a correspondingly higher amount of revenue to be shared with AEP Texas's customers.

AEP Texas filed a motion for rehearing on the grounds that the Commissioners' decision violated the Federal Power Act[2]

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2. 16 U.S.C. §§ 791a-828c (2000 & Supp. 2005).

and the Supremacy Clause of the United States Constitution,[3] specifically arguing that the Commissioners were federally preempted from reviewing AEPSC's allocation of TMRs and that they were required to accept that allocation methodology until and unless FERC ruled otherwise. The motion was overruled by operation of law, and the Commissioners' order became final and appealable on December 5, 2004. *See* TEX. GOV'T CODE ANN. § 2001.146(c) (West 2000 & Supp. 2005).

On December 21, 2004, AEP Texas filed suit in this Court challenging the Commissioners' final order in PUC Docket 26000[4] to the extent that the Commissioners required AEP Texas to reallocate the TMRs. On December 22, 2004, AEP Texas also filed a petition for judicial review in state district court in Travis County, Texas, challenging other aspects of the Commissioners' decision but reserving the contentions raised in this appeal. *See TNC v. Public Util. Comm'n,* Docket No. GN4-04175, 98th Dist. Ct., Travis County, Texas (filed Dec. 22, 2004).

II. Analysis

Summary-Judgment Standard

Pursuant to Rule 56 of the Federal Rules of Civil Procedure, summary judgment is proper where there is no genuine dispute of a material fact that a party is entitled to judgment as a matter of law. *See Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248; *Williams v. Adams,* 836 F.2d 958, 960 (5th Cir.1988). "If the moving party meets the initial burden of showing there is no

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3. U.S. CONST. art. VI, § 2.

4. *Application of West Texas Utilities for Authority to Reconcile Fuel Costs,* PUC Docket No. 26000, Order on Rehearing (Oct. 18, 2004).

genuine issue of material fact, the burden shifts to the nonmoving party to produce evidence or designate specific facts showing the existence of a genuine issue for trial." *Allen v. Rapides Parish Sch. Bd.*, 204 F.3d 619, 621 (5th Cir. 2000) (internal quotations and citations omitted). When both parties move for summary judgment, the court reviews each party's motion independently, viewing the evidence and inferences in the light most favorable to the nonmoving party. *Ford Motor Co. v. Texas Dept. of Transp.*, 264 F.3d 493, 498 (5th Cir. 2001) (citing *Taylor v. Gregg*, 36 F.3d 453, 455 (5th Cir. 1994)). Doubts are to be resolved in favor of the nonmoving party, and any reasonable inferences are to be drawn in favor of that party. *See Burch v. City of Nacogdoches*, 174 F.3d 615, 619 (5th Cir. 1999). However, "[n]either 'conclusory allegations' nor 'unsubstantiated assertions' will satisfy the non-movant's burden," *Wallace v. Texas Tech Univ.*, 80 F.3d 1042, 1047 (5th Cir. 1996), and only disputes over facts that might affect the outcome of the lawsuit under governing law will preclude the entry of summary judgment, *see Anderson*, 477 U.S. at 247-48.

Summary judgment is designed to "secure the just, speedy and inexpensive determination of every action." *Celotex Corp. v. Catrett*, 477 U.S. 317, 327. A claim for declaratory judgment is appropriate for summary judgment when it presents questions of law for the court. *Millennium Petrochemicals, Inc. v. Brown & Root Holdings, Inc.*, 390 F.3d 336, 339 (5th Cir. 2004). Matters regarding federal preemption are questions of law for the court. *E.g., Texas Manufactured Housing Ass'n. Inc. v. City of La Porte*, 974 F.Supp. 602, 604, 607 (S.D. Tex. 1996). Accordingly, whether the Commissioners' actions are constitutionally valid is a question of law that this Court may decide on summary judgment.

Federal Preemption under Federal Power Act and Supremacy Clause

AEP Texas asserts that the Commissioners' assumption of jurisdiction is foreclosed by *Entergy Louisiana, Inc. v. Louisiana Pub. Serv. Comm'n*, 539 U.S. 39 (2003). AEP Texas argues that *Entergy Louisiana* held that state regulatory authorities may not second guess the allocation of costs and revenues among operating companies in a multistate power system even where, as here, the federal tariff has "delegate[d] discretion to the regulated entity to determine the precise . . . allocation." *Id.* at 42. Because Congress has given FERC exclusive jurisdiction to interpret and enforce the terms of the federal tariff, AEP Texas argues, FERC alone may determine the reasonableness of the regulated utility's allocation of costs or revenues under a FERC tariff, and the Commissioners must accept the costs and revenues set under such tariffs and pass them through to retail customers unless and until FERC determines otherwise.

In their response and cross-motion for summary judgment, the Commissioners assert that their decision to reject AEPSC's allocation of TMRs was entirely proper because they properly read and applied the terms of the SIA and, following the plain language of the SIA, their decision violates neither the Federal Power Act nor the Supremacy Clause.[5]

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5. The Intervenors' response to AEP Texas's motion for summary judgment argues that federal preemption and the filed-rate doctrines do not apply to the Commissioners' actions in this cause because the Commissioners are only applying the federal tariff under the terms of the SIA. This argument is subsumed in that of the Commissioners, and therefore this Court will address both arguments together.

The dispute in this cause centers on the Commissioners' decision to exclude the value of the open transaction from AEPSC's allocation of TMRs under the SIA. Section 1.39 of the SIA defines TMRs as the difference between "revenues collected" and out-of-pocket costs plus transmission expenses and section 1.9 of the SIA defines "Base Year" allocation as the relative percentage of total margins "received" by the AEP operating companies, on the one hand, and the CSW operating companies, on the other. The Commissioners argue that because AEPC neither collected revenue, nor received a realization during the Base Year from open transactions, the plain language of section 1.9 and 1.39 of the SIA required AEPSC to exclude such transactions from the Base Year allocation.

The parties agree that FERC has exclusive jurisdiction to regulate interstate wholesale-power rates and that the "filed rate doctrine" requires the Commissioners to follow the terms of the SIA when setting AEP Texas's retail rates. *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 965-6 (1986). The Commissioners argue, however that the SIA provides no discretion for AEPSC to alter the definition of TMRs under section 1.39 of the SIA. AEP Texas argues that the SIA says nothing about AEPSC's use of a particular accounting methodology, and therefore the Commissioners may not review AEPSC's allocation of TMRs.

The Federal Power Act grants FERC exclusive jurisdiction to regulate the transmission and sale of electric energy at wholesale in interstate commerce. 16 U.S.C. § 824. The act provides that all rates and charges, and all rules and regulations affecting such charges, must be "just and reasonable," *id.* at § 824d(a), and nondiscriminatory, *id.* at § 824d(b). To enable FERC to enforce this prohibition, section 205(c) of the Federal Power Act requires public utilities to file with FERC

"schedules" or "tariffs" that show that their rates and charges for wholesale sales of electricity and the classifications, practices, and regulations affecting such charges, together with all contract which in any manner affect or relate to such charges. *Id.* at § 824d(c). The SIA is a federally approved tariff on file with FERC as a rate schedule. Schedule D3 of the SIA provides the methodology for AEPSC's allocation of TMRs.

The United States Supreme Court has consistently construed the Federal Power Act to grant FERC jurisdiction to make all determinations required to regulate wholesale rates and to allocate costs among affiliated utilities, regardless of the impact on state regulation. *See FPC v. Southern Cal. Edison Co.*, 376 U.S. 205, 215-16 (1964); *Montana-Dakota Utils. Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246, 251-52 (1951). Any state action is therefore preempted if its effect is to interfere with FERC's interstate allocation of costs among the companies of an integrated power system. *See Maryland v. Louisiana*, 451 U.S. 725, 749-50 (1981).

The Supreme Court developed the "filed-rate doctrine" to "enforce the exclusive jurisdiction vested by Congress in FERC" and thereby give effect to the Supremacy Clause. *Nantahala Power & Light Co.*, 476 U.S. at 966, 969. Under this doctrine, interstate power rates that are filed with FERC or fixed by FERC must be treated as lawful in a state or federal proceeding unless and until they are changed by FERC, *id.* at 970, and no tribunal may enter an order that would have the effect of "authoriz[ing] commerce in the commodity on other terms." *Montana-Dakota Utils. Co.*, 341 U.S. at 251.

In *Entergy Louisiana*, the Supreme Court held that state law was preempted under the filed-rate doctrine notwithstanding the nonspecific nature of the FERC tariff in question, which "delegate[d] discretion to the regulated entity to determine the

precise cost allocation" between affiliated companies that was being challenged. 539 U.S. at 42. The Court then rejected the argument that the filed-rate doctrine is limited to tariffs providing specific mandates, holding that "[i]t matters not whether FERC has spoken to the precise classification ..., but only whether the FERC tariff dictates how and by whom that classification should be made." *Id.* at 49-50.

The overriding principle from *Entergy Louisiana* is that FERC has exclusive jurisdiction over transactions among affiliated utilities operating an interstate power pool and over all the complex interrelated questions that these arrangements present. "[W]hether one characterizes the questions as related to prudence, interpretation [of the basic service agreements], or cost allocation, they are clearly matters most appropriately resolved by [FERC] as part of its overriding authority to evaluate and implement all applicable wholesale rate schedules." *Mississippi Power & Light Co. v. Mississippi ex rel. Moore,* 487 U.S. 354, 378 (1988) (Scalia, J., concurring in the judgment)(quoting *AEP Generating Co.*, 36 FERC ¶ 61,226, at 61,550 (1986)).

Applying these principles, the Court finds that the Commissioners improperly assumed jurisdiction to review and reject AEPSC's allocation of TMRs. Schedule D of the SIA is a tariff fixed by and filed with FERC that sets forth how and by whom the allocation of the revenues from selling power among members of an integrated interstate power pool are decided. FERC found that the SIA was "just and reasonable" under Section 205 of the Federal Power Act and approved it. *American Elec. Power Co. & Cent. & SW. Corp.*, 90 FERC ¶ 61,242, at 61,797 (2000). Thus, the omission of AEPSC's use of a particular accounting methodology must be interpreted to grant deference to AEPSC to choose the accounting methodology it will use to allocate the TMRs. It clearly may not

be interpreted to grant the Commissioners the authority to assign their preferred accounting methodology on AEPSC.[6] Therefore, the Commissioners must accept AEPSC's allocation of TMRs under Schedule D3 unless and until FERC says otherwise.[7]

Congress has provided states with the ability to seek a remedy at FERC for any action inconsistent with the federal tariff. Under section 825e of Title 16 of the United States Code, a state may file a complaint with FERC about inter-utility activities and these complaints may ultimately result in FERC action declaring rates, practices, and contracts unjust and unreasonable and establishing new ones. 16 U.S.C. §§ 824e(a), 824d(e), 825e. Thus the Commissioners, dissatisfied with AEPSC's allocation of TMRs under the SIA, may seek a determination from FERC that the SIA has been violated.[8]

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6. The Court also notes that although the PUC has jurisdiction over AEP Texas because AEP Texas provides retail electric services in Texas, the PUC has no jurisdiction over AEPSC that makes the calculations under SIA, which would logically be a precondition to adjudicating claims that its calculations violated that federal tariff.

7. Schedule D3 of the SIA also provides that any new methodology for allocating TMRs, beyond the period of time specified under the terms of the SIA, must be filed with FERC for approval, expressly granting jurisdiction to review AEPSC's allocation methodology with FERC.

8. Having determined that the Commissioners are preempted from reviewing AEPSC's allocation of TMRs under the terms of the SIA, this Court need not address AEP Texas's Commerce Clause argument. U.S. CONST. art. I, § 8, cl. 3.

III. Conclusion

This Court therefore concludes that the Commissioners' actions, in violation of the Federal Power Act and the Supremacy Clause, usurped a function that Congress has assigned to FERC. *See Nantahala Power & Light Co.*, 476 U.S. at 964. The sole remedy for any alleged violation of the SIA is at FERC. The Commissioners therefore were preempted from deciding that issue. In accordance with the foregoing:

IT IS ORDERED that Plaintiff AEP Texas North Company's Motion for Summary Judgment filed February 23, 2005 (Doc. # 11) is **GRANTED**.

IT IS FURTHER ORDERED that the Commissioners' Cross-Motion for Summary Judgment filed April 1, 2005 (Doc. # 27) is **DENIED**.

IT IS FINALLY ORDERED and **DECLARED** that Defendants Commissioners Paul Hudson, Julie Parsley, and Barry Smitherman are preempted by federal law under the Federal Power Act and the Supremacy Clause of the U.S. Constitution, and Defendants are **ENJOINED** from enforcing their ruling regarding the allocation of trading and marketing realizations in the following matter: *Application of West Texas Utilities for Authority to Reconcile Fuel Costs,* PUC Docket No. 26000.

SIGNED this 19th September, 2005.

LEE YEAKEL
UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF TEXAS
AUSTIN DIVISION

AEP TEXAS NORTH COMPANY, PLAINTIFF,	§	CAUSE No.
V.	§	A-04-CA-1069-LY
PAUL HUDSON, CHAIRMAN OF THE PUBLIC UTILITY COMMISSION OF TEXAS, JULIE PARSLEY, COMMISSIONER OF THE PUBLIC UTILITY COMMISSION OF TEXAS, AND BARRY SMITHERMAN, COMMISSIONER OF THE PUBLIC UTILITY COMMISSION OF TEXAS, DEFENDANTS.	§	

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FINAL JUDGMENT

Before the Court is the above-entitled cause. On this same date, this Court signed a Memorandum Opinion and Order on cross-motions for summary judgment denying Defendants' Cross-Motion for Summary Judgment, granting Plaintiff's Motion for Summary Judgment, and ordering and declaring that Defendants' ruling was preempted by federal law. Accordingly, the Court enters the following Final Judgment pursuant to Federal Rule of Civil Procedure 58.

IT IS HEREBY ORDERED AND DECLARED that Defendants Commissioners Paul Hudson, Julie Parsely, and Barry Smitherman are preempted by federal law under the Federal Power Act and the Supremacy Clause of the U.S. Constitution, and Defendants are ENJOINED from enforcing their ruling regarding the allocation of trading and marketing realizations in the following matter: *Application of West Texas Utilities for Authority to Reconcile Fuel Costs*, PUC Docket No. 26000.

IT IS FURTHER ORDERED that all relief not expressly granted is hereby DENIED.

IT IS FINALLY ORDERED that the case hereby **CLOSED**.

SIGNED this 26th day of September, 2005.

LEE YEAKEL
UNITED STATES DISTRICT JUDGE

IN THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

No. 05-51755

U.S. COURT OF APPEALS
FILED
JAN 26 2007
CHARLES R. FULBRUGE III
CLERK

AEP TEXAS NORTH COMPANY
Plaintiff-Appellee

v.

TEXAS INDUSTRIAL ENERGY CONSUMERS
Intervenor-Defendant

v.

CITIES OF ABILENE, BALLINGER, CISCO, SAN ANGELO AND VERNON, TEXAS
Intervenor-Defendant-Appellant

v.

THE PUBLIC UTILITY COMMISSION OF TEXAS, ET AL.
Defendants

PAUL HUDSON, Chairman of the Public Utility Commission of Texas; JULIE PARSLEY, Commissioner of the Public Utility Commission of Texas; BARRY T. SMITHERMAN, Commissioner of the Public Utility Commission of Texas
Defendants-Appellants

Appeal from the United States District Court for the Western District of Texas, Austin

ON PETITION FOR REHEARING AND REHEARING EN BANC

(Opinion 12/21/06, 5 Cir., _____, _____ F.3d _____)

Before REAVLEY, STEWART and CLEMENT, Circuit Judges.

PER CURIAM:

(✓) The Petitions for Rehearing is DENIED and no member of this panel nor judge in regular active service on the court having requested that the court be polled on Rehearing En Banc, (FED. R. APP. P. and 5th CIR. R. 35) the Petition for Rehearing En Banc is also DENIED.

( ) The Petitions for Rehearing is DENIED and the court having been polled at the request of one of the members of the court and a majority of the judges who are in regular active service and not disqualified not having voted in favor, (FED. R. APP. P. and 5th CIR. R. 35) the Petition for Rehearing En Banc is also DENIED.

( ) A member of the court in active service having requested a poll on the reconsideration of this cause en banc, and a majority of the judges in active service and not disqualified not having voted in favor, Rehearing En Banc is DENIED.

ENTERED FOR THE COURT:

United States Circuit Judge

REHG-4A

PUC DOCKET NO. 26000
SOAH DOCKET NO. 473-02-3169

APPLICATION OF WEST TEXAS UTILITIES FOR AUTHORITY TO RECONCILE FUEL COSTS	**§**	**PUBLIC UTILITY COMMISSION OF TEXAS**

ORDER ON REHEARING

This Order addresses West Texas Utilities Company's (WTU's)[1] application for reconciliation of its fuel expenses and revenues for the period from July 1, 2000 through December 31, 2001. This is the final fuel reconciliation for WTU. Except as provided in this Order on Rehearing, the Public Utility Commission of Texas adopts the proposal for decision (PFD) and supplemental PFD, including findings of fact and conclusions of law, issued by the administrative law judges (ALJs) for the State Office of Administrative Hearings (SOAH) on March 24, 2003 and December 3, 2003, respectively. As discussed below, the Commission reverses the ALJs on the following issues: (1) the reconciliation period; (2) the length of time WTU must share off-system sales margins with its customers; (3) the inclusion of "negative margins" in computing energy-trading margins generated by the American Electric Power Company, Inc. (AEP) companies' trading activity; and (4) the inclusion of the value of "open transactions" in calculating those energy-trading margins. The fourth item was raised in motions for rehearing.

WTU's application, as modified by this Order on Rehearing, is approved.

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1. Effective December 23, 2002, the legal name of WTU changed to AEP Texas North Company.

I. BACKGROUND

* * *

On March 22, 2004, the Office of Public Utility Counsel (OPC) and the Cities of Abilene, Ballinger, Cisco, San Angelo, and Vernon (collectively Cities) filed motions for rehearing on the question of WTU's inclusion of the value of "open transactions" in calculating energy-trading margins. These parties contended that the ALJs erred in accepting WTU's calculation of those margins. Specifically, they claimed that WTU's affiliate American Electric Power Service Company (AEPSC) inappropriately included the "mark-to-market" (MTM) based value of open transactions in determining the energy-trading margins contributed by the AEP East operating companies in the base year of July 1, 1999 through June 30, 2000. Consequently, they charged, the combined AEP East and West companies' base-year margins total was inflated; more importantly, the allocated share of the aggregated AEP reconciliation-period margins going to the AEP West companies (including WTU) was understated, causing WTU's customers to receive insufficient credit for those margins.[2]

WTU disputed OPC's and Cities' claim, arguing that the inclusion of MTM-valued open transactions in calculating the AEP East companies' margins was entirely appropriate.[3]

At its May 13, 2004 open meeting, the Commission granted the intervening parties' motion for rehearing. As discussed in section II.C. below, the Commission found that

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2. *See* Motions for Rehearing of OPC and Cities (Mar. 22, 2004).

3. *See* WTU's Reply to Motions for Rehearing (Mar. 31, 2004).

AEPSC inappropriately included the MTM-based value of open transactions in determining the energy-trading margins contributed by the AEP East operating companies in the base year. Consequently, the combined AEP East and West companies' base-year margins total was inflated by approximately $84.2 million. In addition, the share of the aggregated AEP reconciliation-period margins going to the AEP West companies was understated, and WTU's customers received insufficient credit for those margins.[4]

The Commission also found, however, that the record contained insufficient evidence on the dollar impact of the above ruling on WTU's final fuel-expense balance. Therefore, the Commission again remanded this docket to SOAH to determine that impact.[5]

Following this second remand, all parties in this case reached agreement on the dollar impact of the Commission's ruling regarding the open transactions. The Commission adopts the parties' agreed-upon findings, as outlined in the discussion section below.

II. Discussion

* * *

D. Including the Value of Open Transactions in Energy-Trading Margins

Pursuant to the SIA, the AEP companies' energy trading and marketing margins are allocated between the AEP West and AEP East operating companies in two tiers. The first tier is based on a ratio of pre-merger CSW margins to pre-merger AEP East margins in the base year, *i.e.*, July 1999 through June 2000. Transactions are allocated based on

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4. *See* Second Order on Remand (May 20, 2004).

5. *Id.*

that ratio until the base-year level of margins is reached. After the base-year level of margins is reached, additional margins are shared according to the ratio of owned generating capacity.

AEPSC reported that the base-year (and hence first-tier) margin allocator for the AEP East companies was 91%, whereas the allocator for the AEP West (formerly CSW) companies was 9%. OPC and Cities objected that this allocation underestimated the correct base-year allocator for the AEP West companies by inappropriately including $84.2 million for the estimated value of "open transactions"[6] at the end of the base year.[7]

To value the unrealized gain or loss of an open transaction over the term of such a contract, AEPSC used MTM accounting. Stating that "[o]ther parties assailed these methods in argument, but provided no actual evidence to rebut WTU's position,"[8] the ALJs in this case accepted AEPSC's inclusion of MTM-valued open transactions in calculating base-year margins for the AEP East companies.

The Commission disagrees with the apparent view of the ALJs that the inclusion of the MTM-valued open transactions is an accounting issue. Section 1.9 of the SIA defines the "Base Year Allocation" as the "relative percentages of the total Trading and Marketing *realization* from Off-System Sales . . . *received* by the AEP Operating Companies, on the one hand, and the CSW Operating Companies, on the other hand" during the 12 months preceding the effective date of the merger. (Emphasis

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6. *See* PFD at 46.

7. *See* Supplemental Direct Testimony of Scott Norwood, OPC Ex. 22 at 26 (Oct. 29, 2002).

8. PFD at 64.

added.) "Trading and Marketing Realization" is defined in Section 1.39 of the SIA as "the difference between (i) *revenues collected* from Trading and Marketing Activities and (ii) the Out-of-Pocket Cost of such Trading and Marketing Activities and any transmission cost related to such activities." (Emphasis added.) This language from the SIA clearly indicates that it is actual revenues and expenses from settled transactions (either from physical delivery or bookouts) that are to be included in the base-year margin calculation, not the value of open positions. The SIA says nothing about the use of MTM accounting to value open transactions. The MTM values did not represent revenues collected, but were just interim estimates of the value of the AEP East open transactions at the end of the base year. Accordingly, the Commission reverses the findings of the ALJs in this case regarding the inclusion of MTM-valued open transactions in the AEP East margin calculation.

Excluding the $84.2 million from the AEP East base-year margins total affects the sharing of margins in two respects. First, the exclusion decreases the AEP East first-tier share to 87% and increases the AEP West first-tier share to 13%; second, the exclusion lowers the base-year level of total AEP margins, so that the $84.2 million is allocated on the second-tier basis of owned generating capacity.[9] Because the AEP West companies' 40% share of generating capacity greatly exceeds their 13% first-tier share, the increase in the level of post-base-year trading margins subject to the generating-capacity allocator increases the energy-trading revenues allocated to WTU and the other AEP West companies.[10]

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9. *See* Norwood Supplemental Direct, OPC Ex. 22 at 27.

10. *Id.*

Under the parties' stipulation after the second remand, the effect of removing the MTM-based value of open transactions is an increase of $3,235,526 in the margins passed through to WTU's Texas retail customers during the 18-month reconciliation period (July 2000-December 2001). With this adjustment, the share of the reconciliation-period margins going to Texas retail customers rises to $5,774,177.

Consistent with the Commission's decision (discussed in section II.B.) to require WTU to continue sharing margins for the 42 months beyond 2001, the parties also calculated the increase in margins flowing through to WTU's Texas retail customers during the post-reconciliation period. This effect is an increase of $4,638,254 going to those customers. With this increase, the total share of the AEP Companies' post-reconciliation margins going to WTU's Texas retail customers is $14,091,805.

Combining the customers' share of margins during the reconciliation and post-reconciliation periods yields a total of $19,865,982, which is an increase of $7,873,780 resulting from the removal of the open transactions from the margin-sharing.

* * *

Second Remand Proceeding

84. At the May 13, 2004 open meeting, the Commission granted intervenors' motions for rehearing on the issue of inclusion of the mark-to-market (MTM) value of open transactions in calculating base-year trading margins and remanded that issue back to SOAH for further evidence to establish the dollar impact on off-system sales margins of excluding the value of open transactions. [Stipulated finding of fact 1.]

85. On May 20, 2004, the Commission issued its Second Order on Remand, finding it inappropriate to include

the MTM value of open transactions in determining the energy-trading margins contributed by the AEP East operating companies in the base year of July 1, 1999 through June 30, 2000. [Stipulated finding of fact 2.]

86. On June 8, 2004, the ALJ issued Order No. 20, adopting a procedural schedule. [Stipulated finding of fact 3.]

87. On July 24, 2004, WTU filed a status report indicating that the parties reached an agreement and jointly filed an agreed-upon Stipulation of Fact. WTU also filed a motion to abate the procedural schedule and a request to return the proceeding to the Commission for issuance of a final order. [Stipulated finding of fact 4.]

88. On July 6, 2004, the ALJ issued Order No. 21, admitting the Stipulation of Fact into the record and returning the case to the Commission for disposition. Order No. 21 also required the parties to file joint proposed findings of fact and conclusions of law. [Stipulated finding of fact 5.]

Mark-to-Market Accounting

89. Under Service Schedule D of the SIA, Trading and Marketing Realizations are to be allocated on an hourly basis between AEP East and AEP West companies in accordance with the Base Year Allocation up to the level of realizations achieved in the Base Year, and for any realization achieved in excess of the base-year amount, allocated according to the ratio of owned generating capacity.

90. *Trading and Marketing Realizations* is defined in the SIA as "the difference between (i) revenues collected from Trading and Marketing Activities and (ii) the Out-of-Pocket Costs of such Trading and Marketing

Activities and any transmission cost related to such activities.

91. *Base Year Allocation* is defined in the SIA as the "relative percentages of the total Trading and Marketing realization from Off-System Sales (other than Off-System Sales having a term of one-year or longer entered into prior to the Merger) received by the AEP Operating Companies, on the one hand, and the CSW Operating Companies, on the other hand, during the last full twelve (12) calendar month period prior to the Effective Time as defined in the Agreement and Plan of Merger (the "Base Year").

92. Mark-to-market valuation of an open position is an estimated value of the contract and is not an amount of revenues collected under such contract. Valuing an open position does not result in AEP receiving revenues.

93. The value assigned to an open position is not determinative of the amount of revenue, if any, that would be received when that position is closed out during a later accounting period.

94. The effect of removing the mark-to-market value of open transactions from the base-year allocation is an increase of $3,235,526 in the margins passed through to WTU's retail customers during the reconciliation period. With this adjustment, the Texas retail customers' share of margins for the reconciliation period is $5,774,177. (See Joint Exhibit No. 1.) [Stipulated finding of fact 6.]

95. The Commission determined that WTU has an obligation to share margins generated after the close of the reconciliation period. The Commission also indicated that it would adopt Scott Norwood's method

of estimating post-reconciliation margins. The effect of removal of the MTM value of open transactions from the base-year allocation results in an increase of $4,638,254 in the margins passed through to WTU retail customers in the 42 months after the close of the reconciliation period. With this adjustment, the Texas retail customers' share of the post-reconciliation period margins would be $14,091,805. (See Joint Exhibit No. 1.) [Stipulated finding of fact 7.]

IV. Conclusions of Law

* * *

24A. The Commission found that it is inappropriate to include the mark-to-market (MTM) value of open transactions in determining the energy-trading margins contributed by the AEP East operating companies in the base year of July 1, 1999 through June 30, 2000. [Stipulated conclusion of law 1.]

24B. The amounts referred to in finding of facts. 94 and 95 accurately reflect the effect of the Commission's ruling concerning the impact of removing the MTM value of open transactions. [Stipulated conclusion of law 2.]

* * *

SIGNED AT AUSTIN, TEXAS the 18th day of October 2004.

PUBLIC UTILITY COMMISSION OF TEXAS

JULIE PARSLEY, COMMISSIONER

PAUL HUDSON, CHAIRMAN

BARRY T. SMITHERMAN, COMMISSIONER

FILED
MAY 22 2007
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SUPREME COURT, U.S.

No. 06-1438

IN THE
SUPREME COURT OF THE UNITED STATES

PAUL HUDSON, ET AL.,
Petitioners,
v.
AEP TEXAS NORTH COMPANY, ET AL.,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

BRIEF OF THE CITIES OF ABILENE, BALLINGER, CISCO, SAN ANGELO AND VERNON, TEXAS AS RESPONDENTS IN SUPPORT OF PETITION

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QUESTION PRESENTED

This Petition raises the question reserved by the Court in *Entergy Louisiana, Inc. v. Louisiana Public Service Commission*, 539 U.S. 39 (2003). That question is:

When there is a dispute over the meaning of a federally-approved tariff in a state retail utility rate proceeding, are States preempted from ensuring that the filed rate is used?

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BRIEF OF THE CITIES OF ABILENE, BALLINGER, CISCO, SAN ANGELO AND VERNON, TEXAS AS RESPONDENTS IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

The Cities of Abilene, Ballinger, Cisco, San Angelo and Vernon, Texas (collectively "Cities") were parties in the court of appeals and are, therefore, technically Respondents in this Court. *See* Sup. Ct. R. 12.6 ("All parties other than the petitioner are considered respondents...."). The Cities participated in the underlying case at the Public Utility Commission of Texas ("PUC" or "Commission") (PUC Docket No. 26000), AEP Texas North Company's ("TNC's") appeal of the PUC's Order to the district court and at the Fifth Circuit. Cities support the PUC's position on the issue raised in the Petition. Therefore, the Cities ask this Court to grant the Petition. *See* Sup. Ct. R. 12.6 ("a response supporting the petition shall be filed within 20 days after the case is placed on the docket").

In the event this Court issues a writ of certiorari, the Cities will file a Brief on the Merits as Respondents supporting the Petitioner. *See* Sup. Ct. R. 25.1 ("Any respondent ... who supports the petitioner ... shall meet the petitioner's ... time schedule for filing documents.").

STATEMENT

The underlying issue in this case surrounds the PUC's ruling on TNC's calculation of electricity sales' profits to be shared with Texas retail electric customers under the terms of their Federal Energy Regulatory

Commission ("FERC") approved System Integration Agreement ("SIA"). Under the filed-rate doctrine, operating agreements, such as the SIA, filed with and approved by the FERC are binding upon state commissions. This Petition raises the unsettled federal question of whether States are preempted under the filed-rate doctrine from reviewing and applying the express terms of a FERC-approved tariff. As part of an overlapping regulatory scheme, States are routinely called upon to resolve disputes over the application of such tariffs. Consequently, this Petition addresses an important federal question with widespread implications.

The SIA is an agreement between the AEP operating companies on file with FERC, and governs the allocation of off-system sales margins between their East and West Zones.[1] In the underlying case, TNC asserted the off-system sales margins were calculated in accordance with the SIA and a merger settlement agreement previously approved by the PUC. The Company invited the Commission to review the FERC-approved SIA and sought a finding that its calculations were in compliance with the merger settlement agreement.

To ensure TNC's compliance with the SIA, it was necessary for the Commission to review and apply the

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[1] The SIA defines the East Zone as: the electric generation, transmission and distribution facilities of the AEP Operating Companies, in total, that constitute the AEP Control Area. The West Zone is comprised of the electric generation, transmission and distribution facilities of the CSW Operating Companies, in total, that constitute CSW's Control Areas in the Southwest Power Pool ("SPP") and Electric Reliability Council of Texas ("ERCOT").

FERC-approved tariff. The Commission followed the formula for allocating margins set out in the SIA to confirm whether TNC complied with its tariff. Specifically, the Commission found that TNC failed to comply with the plain language of the SIA in apportioning the profits to the East and West Zones.

Historically, the presumption has been that state regulatory action is not preempted.[2] Furthermore, this Court has recognized that not every provision and term of a FERC-approved contract drapes FERC with exclusive jurisdiction. Under the court of appeal's decision, however, FERC has sole jurisdiction over any matter related to a FERC-approved tariff. Expansion of the preemption doctrine to exclude States from all issues implicated by federally-approved tariffs is not necessary as the existing process has worked for decades. Under this process, when a utility files an application at the state commission it must, under the filed-rate doctrine, comply with any applicable federal contract, rule and/or tariff. The States, also bound by the FERC-approved contract, rule or tariff, construe the relevant provision and give it binding effect. If a state fails to give the federal tariff binding effect in a manner which results in "trapped costs," the utility is entitled to appeal the decision. Moreover, absent clarification by this Court as to the proper role of States in such situations, an unworkable regulatory paradigm will exist where States will be obligated to seek FERC direction whenever, during the fulfillment of their regulatory functions, a federally-approved tariff is implicated. In order to keep from

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[2] *See New Orleans Public Service, Inc. v. City of New Orleans*, 911 F.2d 993, 1002 (5th Cir. 1990).

disrupting the existing scheme by expanding the federal preemption doctrine to prohibit state commissions from reviewing federal tariffs this Court should grant the Petition.

REASONS FOR GRANTING THE WRIT

Certiorari should be granted for two reasons. First, this Court in *Entergy Louisiana, Inc. v. Louisiana Public Service Commission,* 539 U.S. 39 (2003) expressly reserved ruling upon the issue presented in this Petition: whether a State, in setting retail rates, may decide a dispute over the meaning of a tariff filed with the FERC. This is an important issue that has not been directly addressed in previous decisions. Second, the Fifth Circuit erred in determining that FERC is the exclusive venue to review and apply the express terms of a federally-approved tariff. This Court should clarify that, although States are clearly bound by the filed-rate doctrine, they are not preempted from construing a federally-approved tariff in order to determine whether a utility is in compliance with the tariff.

I. QUESTION PRESENTED BY PETITION RAISES IMPORTANT PREEMPTION ISSUE RESERVED BY THE COURT IN *ENTERGY LOUISIANA, INC. V. LOUISIANA PUBLIC SERVICE COMMISSION*

The Fifth Circuit relied on *Entergy Louisiana, Inc.*, and its precursors in ruling that States are precluded from having any role in reviewing a FERC-sanctioned tariff which affects retail rates. However, in *Entergy Louisiana, Inc.* this Court reserved ruling on the question of "the

exclusivity of FERC's jurisdiction to determine whether, and when a filed rate has been violated." 539 U.S. 51. The court of appeals held that the preemption doctrine prevents States from reviewing or interpreting a FERC tariff. However, the cases relied on by the Fifth Circuit require state commissions to give binding effect to FERC-approved tariffs.[3] Yet, the lower court did not explain how a State is to give "binding effect" to FERC rate schedules and tariffs without reading, evaluating and interpreting the schedules and tariffs.

The regulation of utilities is "...one of the most important of the functions traditionally associated with the police power of the states."[4] Like many states, the Texas PUC regulates several utilities that are also subject to the jurisdiction of FERC.[5] Accordingly, States are required to

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[3] *Entergy Louisiana, Inc. v. Louisiana Public Service Commission*, 539 U.S. 39, 47, 49-50 (2003) (second-guessing of classification of units pursuant to FERC tariff prohibited); *Nantahala Power and Light Co. v. Thornburg*, 476 U.S. 953, 972 (1986) (FERC allocation must be respected by North Carolina Commission); *Mississippi Power and Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354, 371 (1988); *Appalachian Power Co. v. Pub. Serv. Comm'n*, 812 F.2d 898, 905 (4th Cir. 1987) ("state regulatory authorities must give effect in calculating retail rate to the costs and allocations reflected in the federally regulated transactions that precede final retail sale of energy").

[4] *Arkansas Electric Cooperative Corp. v. Arkansas Public Service Commission*, 461 U.S. 376, 377 (1983).

[5] The Commission understood that it "...may not impinge upon FERC's jurisdiction by restructuring, elaborating upon or second-guessing the reasonableness of the SIA's terms, as approved by FERC." Proposal for Decision, Record on Appeal, Ex. 6, Tab B at 58 (March 25, 2003).

review FERC-authorized tariffs, contracts and operating agreements in many cases. In order to honor the filed-rate doctrine, States must examine and understand what the tariffs require. It is, therefore, unremarkable that States must routinely evaluate FERC-approved tariffs and contracts to accomplish their duty to regulate utilities.

It is true that "under the filed-rate doctrine, FERC-approved cost allocations between affiliated energy companies may not be subjected to reevaluation in state ratemaking proceedings." 539 U.S. 41-42. As such, it is undisputed that States must assiduously review the applicable federal tariff and carefully comply with its terms. In the underlying case the Texas PUC did not challenge, alter or reevaluate the FERC-ordered revenue allocation. Rather, the PUC complied with the plain language of the tariff and gave the SIA "binding effect" as it was required to do. This Court should clarify whether States are preempted from acting in such a manner or from having *any* role in the determination of whether a utility has violated a filed federal rate.

The interplay between the federal and state regulatory functions is manifest in the facts of the underlying case. The Texas PUC is required by state law to establish rates allowing the utility to collect its reasonable costs necessary to provide electric service.[6] Off-system sales margins, under the Commission's rules, are used to

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[6] Public Utility Regulatory Act ("PURA") §§ 36.051: 36.203(e); 16 TEX. ADMIN. CODE 25.236(d)(1).

off-set fuel expense.[7] The margins to be shared with TNC's retail customers are not the subject of federal law. Likewise, the obligation to off-set fuel expense by off-system sales is a requirement imposed by PUC, not federal, rules. TNC's duty to share profits from sales in other states is attributed to AEP's concession in obtaining the Texas Commission's approval of the merger of AEP and CSW. The SIA approved by FERC distributes sales margins to the two zones -- not to individual operating companies. Accordingly, it is the Texas Commission that has the final say over TNC's agreement to share profits. The Commission's review of the SIA was essential to enforce the terms of the merger settlement agreement.

These facts demonstrate the interrelationship between a state-approved agreement and a federal-approved tariff. Notwithstanding this interaction, the court of appeals found that States must accept a utility's proposed allocation regardless of whether the allocation followed the approved tariffs or not. This view of the filed-rate doctrine is irrational as it severely restricts States from carrying out their portion of the broader regulatory scheme. A more logical application of the doctrine would allow the state body to construe the tariff in question and ensure compliance. That is, in fact, what the Commission did in this proceeding. This Court should reverse the court of appeal's decision and clarify the States' role in reviewing federally-approved tariffs when necessary to fulfill their statutory regulatory duties.

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[7] 16 TEX. ADMIN. CODE 25.236(7)(C).

II. THE FIFTH CIRCUIT'S RESOLUTION OF PETITIONER'S CLAIM IS ERRONEOUS

To effectuate TNC's agreement to share off-system sales margins from other states with its retail customers in Texas, the PUC evaluated TNC's revenue calculations to determine compliance with the FERC-approved SIA. The Commission gave binding effect to the plain terms and provisions of the federal tariff. The courts have repeatedly held that a state commission must give binding effect to the federally-approved tariff. Notwithstanding these facts, the court of appeals enlarged the federal preemption doctrine to prohibit the Texas Commission from considering the SIA. In so doing, the court misapplied the federal preemption doctrine and overlooked TNC's duty to comply with the SIA.

As noted, States are called on to review FERC-approved contracts and operating agreements to perform their duty to regulate utilities. Under the filed-rate doctrine, States have no choice but to comply with the express terms and definitions found in the federally-approved tariffs -- to do otherwise is prohibited. Utilities, similarly, are bound by their tariffs. The filed-rate doctrine not only protects multi-jurisdictional utilities from enduring trapped costs associated with conflicting state orders but also protects the public from a utility charging rates and implementing practices that have not been approved by the applicable regulatory authority.

Under the court of appeal's decision the filed-rate doctrine is a one-way street -- binding only on the States. But the filed-rate doctrine applies to utilities, as well.

Indeed, the doctrine was established in a case where one utility sued another to recover damages for allegedly excessive utility rates. In *Montana-Dakota Utilities Company v. Northwestern Public Service Company*, 341 U.S. 246, 251 (1951) the Court set out the rule that a utility "...can claim no rate as a legal right that is other than the filed rate whether fixed or merely accepted by the Commission...."[8] The Fifth Circuit itself has previously recognized that the public may rely on the filed-rate doctrine:

> [T]he FPA and the filed rate doctrine protect the public interest by imposing severe limitations upon a public utility's ability to alter the terms of those contracts after they are certified by FERC.[9]

Texas law follows the federal scheme -- filed tariffs "govern a utility's relationship with its customers and have the force and effect of law until suspended or set aside."[10] Regulated utilities cannot vary a tariff's terms with

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[8] *See also Nantahala Power and Light Company v. Thornburg*, 476 U.S. 953, 963-64 (1986) ("no rate other than the one on file may be charged"); *Arkansas Louisiana Gas Company v. Hall*, 453 U.S. 571, 577 (1981) (doctrine forbids a regulated entity to charge rates for its services other than those properly filed with the appropriate federal regulatory authority).

[9] *Mirant Corp., et al. v. Potomac Electric Power Company, et al.*, 378 F.3d 511, 525 (5th Cir. 2004).

[10] *Southwestern Electric Power Company v. Grant*, 73 S.W.3d 211, 216-17 (Tex. 2002) citing *Carter v. AT&T Co.*, 365 F.2d 486, 496 (5th Cir. 1966); *see also CenterPoint Energy Entex v. Railroad Commission of Texas*, 2006 WL 431722 at 8 (Tex. App.-Austin).

individual customers, discriminate between customers, or charge rates other than those properly filed with the appropriate regulatory authority.[11] As shown in the PUC's Order, TNC altered the plain terms of the SIA to direct more sales margins to AEP East where there is no obligation to share revenues with retail customers. Under the ruling of the court of appeals, the Texas PUC was powerless to apply the terms of the SIA and enforce the filed-rate doctrine regardless of whether the utility actually complied with the tariff. The decision improperly denies States from having any role in ensuring that utilities comply with their tariffs, while simultaneously giving utilities full discretion to resolve issues related to application of those same tariffs.

In holding that the Texas Commission is precluded from reviewing TNC's revenue allocation, the court of appeals found that the Commission has a remedy at FERC to resolve any disagreements with the utility's application of the federal tariff. Here, again, the lower court did not explain how States are to identify issues to bring to FERC if they lack jurisdiction to evaluate or interpret the federal tariff. Under this decision, even where a utility clearly violates the terms of its tariff, the only remedy a state commission would have would be to abate the proceeding and file a complaint at FERC to enforce the tariff. Such a procedure is unworkable and has never been the law.

When a federal contract or tariff impacts a retail rate determination, the historical practice has been to

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[11] *SWEPCO v. Grant* at 217, citing *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 579 (1981).

review and evaluate the contract or tariff and proceed to give effect to those documents. If the utility believes the Commission has intruded upon the FERC's jurisdiction, it retains the right to appeal the Commission's decision.[12] This system, in place in Texas for over two decades, has worked well. There is no need, using this procedure, to interfere with the processing of cases or to petition and wait on FERC for resolution.

As a practical matter, the state regulatory body has essentially three choices when confronted with a retail rate decision effected by a federal order, rule or tariff:

(1) It can simply accept without review the utility's application of the federal requirement;

(2) It can review and evaluate the utility's calculations and claims regarding the federal contract or tariff, and if it finds the utility has failed to comply with the filed-rate

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[12] *See Public Utility Commission of Texas v. Gulf States Utilities*, 809 S.W.2d 201 (Tex. 1991) (Commission reviews and applies FERC rules); *Entergy Gulf States v. Public Utility Commission, et al.*, 173 S.W.3d 199, 208-09 (Tex. App.-Austin 2005, pet. denied) (PUC reviews wholesale power contract and federally-approved System Agreement); *Gulf States Utilities Company v. Public Utility Commission of Texas*, 841 S.W.2d 459 (Tex. App.-Austin 1992, writ denied) (Commission reviews and applies FERC-approved wholesale power contract); *see also Jenkins v. Entergy Corporation*, 187 S.W.3d 785 (Tex. App.-Corpus Christi 2006, pet. filed) (trial court reviews System Agreement to determine jurisdiction).

doctrine, abate the proceeding and seek resolution from FERC; or

(3) It can review and give binding effect to the federal requirements in making its decisions and issue a final, appealable order. The utility can appeal if it is dissatisfied with the order.

The first option is not viable for most state regulators. It constitutes an abdication of the duty to regulate in a manner that is fair to utilities and customers. The second option assumes jurisdiction to review the tariff but creates procedural hardships. In most states, utility proceedings have directory and mandatory time limits. For example, in Texas a transmission and distribution rate case must be resolved in 185 days.[13] If it is not resolved, under law *the utilities' rate increase request goes into effect.*[14] Moreover, requiring states to affirmatively seek an order from FERC effectively shifts the burden of demonstrating compliance with a tariff from the utilities to the states. Lastly, this approach places a financial burden on many States that do not have the resources to pursue federal complaint actions. As such, it would be unworkable for States to abate a proceeding to obtain a resolution from FERC. The last option complies with the requirement that the agency give binding effect to the federal tariff and allows for efficient completion of the proceeding. In the instant case, TNC could have gone to FERC to complain

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[13] PURA § 36.108(c).

[14] *Id.*

that the allocation was unfair to its customers prior to filing its application at the Texas PUC. Instead, TNC filed its Application with the state commission that reviewed and applied the tariff. Unsatisfied with the result, the utility appealed to the district court. This long standing process preserves the rights of the participants and should be reaffirmed by this Court.

CONCLUSION

For the reasons stated above and in the Petition itself, the Petition for Writ of Certiorari should be **GRANTED**.

Respectfully submitted,

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No. 06-1438

In The
Supreme Court of the United States

PAUL HUDSON, JULIE PARSLEY, AND BARRY SMITHERMAN, as Commissioners of the Public Utility Commission of Texas, in their official capacities,
Petitioners,

v

AEP TEXAS NORTH COMPANY, ET AL.,
Respondents,

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

NATIONAL ASSOCIATION OF REGULATORY UTILITY COMMISSIONERS ET AL. AMICI CURIAE BRIEF SUPPORTING PETITIONERS PAUL HUDSON, JULIE PARSLEY, AND BARRY SMITHERMAN OF THE PUBLIC UTILITY COMMISSION OF TEXAS

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QUESTION PRESENTED

Whether federal law preempts a State from interpreting a FERC-filed tariff where such interpretation is necessary for setting retail rates.

PARTIES TO THE PROCEEDING

The Parties to the proceeding before the Fifth Circuit follow:

Petitioners are Paul Hudson in his official capacity as the Chairman of the Public Utility Commission of Texas, Julie Parsley in her official capacity as Commissioner of the Public Utility Commission of Texas, and Barry Smitherman in his official capacity as Commissioner of the Public Utility Commission of Texas. Respondents are AEP Texas North Company; the Cities of Abilene, Ballinger, Cisco, San Angelo, and Vernon, Texas; and the Texas Industrial Energy Consumers.

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INTEREST OF THE *AMICI CURIAE*[1]

The National Association of Regulatory Utility Commissioners ("NARUC"), a quasi-governmental organization founded in 1889, submits this brief in support of Petitioners Paul Hudson, Julie Parsley and Barry Smitherman, Commissioners of the Public Utility Commission of Texas, in their official capacities. The Public Utility Commission of Texas ("PUCT") is one of NARUC's State commission members.

NARUC is the national organization of the State commissions responsible for economic and safety regulation of the retail operations of utilities. Specifically, NARUC's members have the obligation under State law to ensure the establishment and maintenance of such energy utility services as may be required by the public convenience and necessity, as well as ensuring that such services are provided at just and reasonable rates. NARUC's members include the agencies in the fifty States, the District of Columbia, Puerto Rico, and the Virgin Islands charged with regulating the rates and terms and conditions of service associated with the intrastate operations of electric, natural gas, water, and telephone utilities.

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[1] Sup. Ct. R. 37.2(a) certification: NARUC has obtained the consent of all parties to file this brief. The letters of consent are on file with the Clerk of Court. Sup. Ct. R. 37.6 certification: This brief has not been authored in whole or in part by counsel for a party. No person or entity, other than NARUC, made a monetary contribution to the preparation and submission of this brief.

Both Congress[2] and the federal courts[3] have long recognized NARUC as the proper party to represent the collective interests of State regulatory commissions.

The Iowa Utilities Board, Public Service Commission of Wisconsin, Public Utilities Commission of the State of California, Vermont Department of Public Service and Public Service Commission of the State of New York are established by State Constitutions and/or the laws of their respective States. These Commissions exercise general regulatory jurisdiction over electric utilities and the provision of retail electric service, are charged to protect their State's citizens, and are authorized to represent them in proceedings before the Federal Energy Regulatory Commission (FERC) and courts reviewing FERC decisions.

The Attorneys General of the States of Minnesota North Dakota and Colorado are charged with representing the States of Minnesota and Colorado in all matters in

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[2] See 47 U.S.C. § 410(c) (1971) (Congress designated NARUC to nominate members of Federal-State Joint Boards to consider issues of concern to both the Federal Communications Commission and State regulators with respect to universal service, separations, and related concerns); Cf., 47 U.S.C. § 254 (1996) (describing functions of the Joint Federal-State Board on Universal Service). Cf. *NARUC, et al. v. ICC,* 41 F.3d 721 (D.C. Cir 1994) (where the Court explains "...Carriers, to get the cards, applied to... [NARUC], an interstate umbrella organization that, as envisioned by Congress, played a role in drafting the regulations that the ICC issued to create the "bingo card" system).

[3] See *United States v. Southern Motor Carrier Rate Conference, Inc.,* 467 F. Supp. 471 (N.D. Ga. 1979), aff'd 672 F.2d 469 (5th Cir. 1982), aff'd en banc on reh'g, 702 F.2d 532 (5th Cir. 1983), rev'd on other grounds, 471 U.S. 48 (1985).

which the State has an interest, including utility matters, and with representing the Minnesota Public Utilities Commission, North Dakota Public Service Commission and the Colorado Public Utilities Commission before federal and State courts.

NARUC's member commissions have a *vital* interest in whether this Court accepts the PUCT's Petition for a Writ of Certiorari.

The Fifth Circuit's decision is a significant threat to effective State regulation of retail rates. It preempts States, during retail ratemaking, from *applying* the unambiguous text of a federal tariff; requires States to interrupt proceedings to seek FERC clarification of the utility's construction of the tariff, *no matter how far it diverges from the statutory text*; and effectively gives a utility *carte blanche* to effectively stay State retail ratemaking procedures.[4] *Anytime* a utility disagrees with the State commission's *application* of the tariff - *even when the text is crystal clear* - under the 5th Circuit's decision, the *only* remedy is to stop the proceeding and seek FERC's view of the disputed provision (or for the State commission to yield to the utility's arguments).[5] This result is an invitation to waste both federal and State resources and delay critical State proceedings.

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[4] See *AEP Texas North Co. v. The Public Utility Commission of Texas*, 473 F.3d 581 (5th Cir. 2006).

[5] This turns the ordinary progress of appeals in this context on its head. Ordinarily, the States can finish their proceedings *before* facing an appeal and perhaps a primary jurisdiction referral of the disputed text to the FERC. Under the 5th Circuit's formulation, practically, the utility is given significant leverage as the State commission cannot disagree with any utility construction of a tariff without potentially facing an injunction to *permanently* stay its proceedings.

The extraordinarily inefficient and impractical procedure mandated also runs contrary to the well-recognized division between State and federal regulatory authority.[6]

The Federal Power Act and its legislative history clearly demonstrate that Congress, when it granted FERC jurisdiction over wholesale sales of electricity and the transmission of electric energy in interstate commerce, expressly reserved jurisdiction over all retail sales of electric energy to the States.

Although the FERC has exclusive jurisdiction to establish wholesale rates and allocate interstate costs, the federalized nature of electricity regulation unavoidably requires States exercising retail rate jurisdiction to routinely *apply* federally filed tariffs. That is all the Texas commission has done here. States set rates to allow utilities to recover reasonable expenses, and the only reasonable amount for a wholesale cost set by a federal tariff is the rate specified in the tariff. In this case, the court of appeals' decision prevents the State agency from looking to the

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[6] See, *Arkansas Elec. Cooperative Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 375, 377 (1983) (FERC authority over wholesale sales of electric energy in interstate commerce is clear, as is this Court's acknowledgement of State authority over retail sales). *Id.* at 377-380. *New York v. FERC*, 535 U.S. 1, 23 (2002) ("Because federal authority has been asserted only over unbundled *transmissions*, New York retains jurisdiction of the ultimate sale of the *energy*."). Even when discussing the central principles of preemption in *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986) and *Mississippi Power & Light Co. v. Mississippi*, 487 U.S. 354 (1988), this Court recognized that the jurisdiction of States over retail rates is indisputable. *Nantahala* 476 U.S. at 970, *cited in Mississippi Power*, 487 U.S. at 372.

federal tariff to determine what rate has been mandated. It is impossible for the PUCT to adhere to the filed rate doctrine and apply the FERC approved tariff in a retail rate proceeding without ascribing some meaning to the text.

The Fifth Circuit's decision establishes a procedure that invites industry manipulation, delay and inefficiency – at ratepayer expense. Reversal of that decision will discourage such manipulation. By conditioning enforcement of facially unambiguous provisions in retail rates on the delays inherent in FERC contested case proceedings, the Fifth Circuit's holding also effectively robs States of any meaningful authority to exercise a key police power in violation of the Federal Power Act.

STATEMENT OF THE CASE

Mindful of the admonitions of U.S. Sup. Ct. Rule 37, NARUC adopts by reference the Statement of the Case presented in the PUCT's Petition for a Writ of Certiorari.

SUMMARY OF ARGUMENT IN FAVOR OF GRANTING THE WRIT

This Court in *Entergy*[7] expressly reserved the question of the exclusivity of the FERC's jurisdiction to determine whether a filed tariff has been violated. The Fifth Circuit's holding that State commissions are preempted from finding a violation of a FERC-filed tariff misreads the *Entergy* decision. Moreover, it misapplies the *Nantahala* and *Mississippi Power* cases. In both decisions, State agencies disallowed costs assessed in compliance with a FERC tariff, contrary to the "filed-rate doctrine," which requires States to enforce federal tariffs. But the doctrine does not prevent a State agency from ascribing some meaning to the federal tariff so that State can correctly apply the terms of those tariffs.

The PUCT specifically *enforced* the provisions of the FERC-filed tariff. The AEP tariff's clear requirement that the calculation of Trading and Marketing Realizations include only "revenues collected" cannot be taken to provide discretion to include in that calculation "revenues *not* collected." Inclusion of revenues where none had been collected indisputably violated the terms of the FERC-filed tariff. In order to "give binding effect" to the tariff, the PUCT was *obligated* to reject TNC's suggested interpretation.

The Fifth Circuit's decision works against the principles of cooperative federalism by denying the States their proper role under the Federal Power Act. If the decision is allowed to stand State commissions will be forced to hold any proceeding in which a utility contests the

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[7] *Entergy Louisiana, Inc. v. Louisiana Public Service Commission*, 539 U.S. 39, 51 (2003).

proposed interpretation of a FERC tariff in abeyance pending resolution of that dispute by FERC. By conditioning State control of retail rates on the delays inherent in FERC contested case proceedings, the Fifth Circuit's holding effectively robs States of meaningful authority to exercise one of their key police powers. This result is contrary to the well-recognized division between State and federal regulatory authority.

ARGUMENT IN FAVOR OF GRANTING THE WRIT

Mindful of the admonitions of U.S. Sup. Ct. Rule 37 concerning original material potentially helpful to the Court, NARUC, to avoid repetition, fully endorses the arguments presented in the PUCT's Petition for a writ. It is clear that (1) the Fifth Circuit reached and incorrectly decided the critical issue this Court reserved in its *Entergy* decision, (2) the Fifth Circuit's determinations will have broad impact and assure inefficient and expensive delay and manipulation of State and FERC administrative process; and (3) the Fifth Circuit decision misapplies prior Supreme Court precedent. Aside from this specific endorsement of the PUCT's arguments, NARUC also offers the following:

I. *The Determination That The PUCT Cannot Apply Unambiguous FERC-Approved Text In Retail Ratemaking Proceedings Is Inconsistent With The Supreme Court's Reasoning In Entergy.*

The Fifth Circuit purported to rely on this Court's decision in *Entergy*. But in that case, this Court expressly reserved the question resolved by the 5th Circuit - the exclusivity of the FERC's jurisdiction to determine whether

a filed tariff has been violated.[8] Clearly, the holdings of *Entergy* cannot directly support the Fifth Circuit's decision to preempt the PUCT's application of the FERC-approved unambiguous tariff terms. Moreover, a closer examination reveals that the *rationale* of the *Entergy* decision fails to support the decision below.

Unlike the circumstances presented in *Entergy*, in this case there is no comparable delegation of discretionary authority to AEP. That alone distinguishes the present case from *Entergy*. Furthermore, any implied delegation of authority to AEP that may exist undoubtedly *did not* include permission to adopt a methodology that is *clearly at odds with the express text FERC approved in the tariff.*

Rather than supporting the *Entergy*'s interest in assuring the FERC determinations are respected, the Fifth Circuit's decision has precisely the opposite impact. As Petitioners argue, Petition at 9, a State might choose to acquiesce in a clearly erroneous industry interpretation rather than face the delays associated with immediate FERC review – defeating the primary purpose of the "filed rate" doctrine. Moreover, where, as here, the tariff text is clear, actions that prevent other authorities from applying or enforcing FERC's decisions can only undermine compliance.

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[8] *Entergy*, 539 U.S. at 51. Nor do *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986) or *Mississippi Power & Light Co. v. Mississippi*, 487 U.S. 354 (1988) support the 5th Circuit's findings. Neither case involves a claim that a utility *breached* the terms of a FERC-filed tariff. Rather both involved efforts by State agencies to disallow costs assessed *in compliance* with FERC tariffs.

II. The PUCT Applied the Unambiguous Tariff Text to Reverse an Obvious Utility Distortion That Blatantly Ignores FERC Requirements.

Delay of the State retail ratemaking to obtain, *ab initio,* guidance from the FERC is notably inappropriate in this case. The language of the tariff is clear on its face. The FERC-approved tariff, the System Integration Agreement ("SIA"), plainly excludes the interpretation offered by AEP Texas North Company ("TNC").

The filed rate doctrine *requires* the PUCT to apply and enforce the FERC-filed SIA in TNC's fuel reconciliation proceeding. The PUCT was obligated to review the tariff to ensure its orders complied with FERC's decisions. This particular SIA requires AEP Service Corporation ("AEPSC"), the agent for the AEP System, to calculate and distribute Trading and Marketing Realizations between the two system zones according to a specific formula. Section 1.39 of the SIA plainly defines "Trading and Marketing Realizations" as:

> the difference between (i) <u>revenues collected</u> from Trading and Marketing activities and (ii) the Out-of-Pocket Cost of such Trading and Marketing Activities and any transmission cost related to such activities. {Emphasis Added}

In performing the calculation described in the SIA, AEPSC was obligated to include only those off-system sales revenues <u>actually collected</u> by the system. *Instead, AEPSC included the values of certain "open" transactions for which no revenues had yet been received.* TNC does not dispute this, but instead asserts its inclusion of *uncollected revenues* as "*collected revenues*" is justified by AEPSC's use of mark-to-market accounting. However,

any construction of the filed tariff that treats "uncollected" revenues as "collected" clearly contradicts the express language FERC approved in the tariff.

The SIA's use of the phrase "revenues collected" simply cannot be interpreted to mean "revenues *not* yet collected." In order to "give binding effect" to the SIA in accordance with the filed rate doctrine,[9] the PUCT was *obligated* to reject TNC's suggested interpretation and to require TNC to calculate its share of margins without including the "open transactions".

III. *Cooperative Federalism Suggests Some Deference to States' Efforts to Comply with the "Filed Rate Doctrine" by Applying the Unambiguous Text of a FERC-Approved Tariff When Setting Retail Rates.*

The Fifth Circuit's decision is contrary to both the filed rate doctrine and the most basic principles of cooperative federalism.

Indeed, the most prominent feature of all the Supreme Court cases cited by the 5th Circuit is their absolute insistence that States implement and apply FERC approved tariffs as part of their retail rate making procedures.[10] This is precisely what the PUCT tried to do.

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[9] *See generally* *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986), and *Mississippi Power & Light Co. v. Mississippi*, 487 U.S. 354 (1988).

[10] *See Entergy*, 539 U.S. at 47 ("The filed rate doctrine requires 'that interstate power rates filed with FERC or fixed by FERC must be given binding effect by [S]tate utility commissions determining intrastate rates.'") (quoting *Nantahala*, 476 U.S. at 962). *See also Mississippi Power*, 487 U.S. at 371 ("FERC-mandated allocations of power are binding

Such exercises are not uncommon features of retail ratemaking by the States. When setting retail rates, States allow utilities to recover their reasonable expenses. If one of those expenses is set by a federal tariff, the only reasonable amount for the expense is the tariffed rate.

The term "cooperative federalism" has been used by this Court to describe laws relying upon coordinated State and Federal efforts within a complementary administrative framework. See, *New York State Department of Social Services v. Dublino,* 413 U.S. 405, 413 (1973) (*Dublino*). As one of these statutory schemes, the Federal Power Act requires that States implement federal directives, including tariffs approved by the FERC. The mandate to give binding effect to FERC tariffs intrinsically requires States to interpret and apply those tariffs. The Fifth Circuit ignores cooperative federalism, wrongly assuming that State can never be permitted to implement part of that federal scheme.

In *Dublino,* 413 U.S. at 421, this Court stated that where, as here, a State works in tandem with the Federal government ". . . in the pursuit of common purposes, the case for federal pre-emption becomes a *less* persuasive one."

The Fifth Circuit's holding works against the principles of cooperative federalism which the Federal Power Act and numerous other statutes embody. In matters involving electric regulation, there is a constant need for the FERC and State commissions to coordinate. Their consideration of nonjurisdictional matters that are subject

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on the States, and States must treat those allocations as fair and reasonable when determining retail rates.").

to each others' jurisdiction is "commonplace."[11] The "savings clause" in FPA Section 201(b), 16 U.S.C. § 824(b), and other sections of the Act make it clear that Congress intended close cooperation between the FERC and States.[12] Numerous other Acts of Congress also depend upon "cooperative federalism" for their success.[13]

If the Fifth Circuit decision is allowed to stand, it will lead to less coordination between States and the federal government. It will lead to waste of both federal and State resources and potentially inject substantial delay, at ratepayer expense, into the regulatory process. State commissions will be forced to hold any proceeding in which a utility contests the agency's application of the terms of a FERC tariff in abeyance pending the resolution of the underlying construction controversy by FERC. The alternative, and for some State commissioners, perhaps the only alternative,[14] may well be to accede to even nonsensical and/or perverse utility constructions of FERC tariffs.

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[11] See, *e.g., Federal Power Commission v. Conway Corp. et al.*, 426 U.S. 271, 280 (1976).

[12] See, *e.g.*, Sections 202 and 209(b), 16 U.S.C. § 824a and 824h(b).

[13] See, *e.g.*, Sections 1, 3A, 9(b), 11, 13 and 17, 15 U.S.C. §§ 717, 717b-1, 717h(b), 717j, 717l, and 717p of the Natural Gas Act, necessitate close coordination between the FERC and State agencies.

[14] State agencies are already handicapped in their efforts to regulate holding company subsidiaries. State agencies operate with limited staffs and pre-approved budgets. When faced with a tariff violation by a parent company, a State may be unable to pursue a complaint case at the FERC because of the cost and obstacles associated with a FERC proceeding.

CONCLUSION

For the reasons set forth above and the reasons stated in the Petition, *Amicus Curiae* respectfully urges the Court to grant the PUCT's Petition for a Writ of Certiorari.
Dated: June 1, 2007

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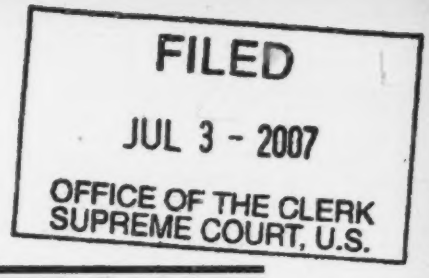

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No. 06-1438

IN THE

Supreme Court of the United States

PAUL HUDSON, ET AL.,

Petitioners,

v.

AEP TEXAS NORTH COMPANY, ET AL.,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIFTH CIRCUIT

BRIEF OF TEXAS INDUSTRIAL ENERGY CONSUMERS AS RESPONDENT IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

This Petition raises an issue left open in *Entergy Louisiana, Inc. v. Louisiana Pub. Serv. Comm'n*, 539 U.S. 39 (2003). That is, in setting retail rates, do the States have authority to find that a utility's rate proposal is inconsistent with a Federal Energy Regulatory Commission (FERC) tariff that must be implemented in the retail rate proceeding?

PARTIES TO THE PROCEEDINGS

Petitioners are Paul Hudson, Chairman of the Public Utility Commission of Texas, and Julie Parsley and Barry Smitherman, in their official capacities as commissioners of the Public Utility Commission of Texas. Respondents are AEP Texas North Company; the Cities of Abilene, Ballinger, Cisco, San Angelo, and Vernon, Texas; and Texas Industrial Energy Consumers.

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BRIEF OF TEXAS INDUSTRIAL ENERGY CONSUMERS IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

Texas Industrial Energy Consumers (TIEC) files this brief in support of the Petition for Writ of Certiorari (Petition) of the Public Utility Commission of Texas (PUC).

TIEC is an association of large industrial users of electricity whose businesses are heavily impacted by electricity costs. TIEC's members purchase substantial amounts of electricity from AEP Texas North Company (TNC) and other American Electric Power (AEP) affiliates.[1] TIEC participated in the underlying proceeding at the PUC and in TNC's appeal of the PUC Order.

STATEMENT

TIEC incorporates by reference the statement of the case as set forth in the Petition.

SUMMARY OF ARGUMENT

The filed rate doctrine requires that the States implement Federal Energy Regulatory Commission (FERC) tariffs that set wholesale electricity rates. The Fifth Circuit's decision would require state utility commissions to accept and implement utility rate proposals that are inconsistent with FERC tariffs. The Fifth Circuit's ruling converts the filed rate doctrine's mandate that state commissions *must* give

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[1] TIEC's members in the AEP service area include Air Liquide Large Industries U.S. L.P., Celanese, Ltd., Chevron Global Power Corporation, CITGO Petroleum Corporation, Dow Chemical Company, E.I. du Pont de Nemours & Company, Flint Hills Resources, Invista S.a.r.l., Lyondell Chemical Company, Occidental Chemical Corporation, Occidental Permian, Ltd., and Valero Energy Corporation.

effect to FERC-approved tariffs into a doctrine that state commissions *cannot* give effect to FERC-approved tariffs if the state-regulated utility proposes to ignore the terms of the FERC tariff.

FERC has plenary jurisdiction to set wholesale rates. 16 U.S.C. § 824(b)(1) (2000 & Supp. 2006); *New York v. Fed. Energy Regulatory Comm'n*, 535 U.S. 1, 16-17 (2000). Setting retail rates, however, is within the States' police powers. *Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 376, 377 (1983). When setting rates in state regulatory proceedings, state commissions are routinely called upon to give effect to FERC wholesale rates under the filed rate doctrine, which is precisely what the PUC did in this case.

In a state proceeding to determine TNC's Texas jurisdictional fuel expenses and revenues, the PUC was called upon to give effect to a merger agreement among utilities, called the System Integration Agreement (SIA). *See* 16 TEX. ADMIN. CODE § 25.236(g) (2007). The SIA, approved as a FERC tariff, included a mechanism to calculate and allocate to Texas customers TNC's profits associated with sales of excess power. Because Texas retail customers pay through their regulated rates for the generation assets that produce TNC's power, those customers are allocated profits from the sale of a utility's excess power (called "off-system sales" or, under the SIA, "Trading Market Realizations" (TMR)). TEX. UTIL. CODE ANN. §§ 36.051; 36.203(e) (Vernon 1998 & Supp. 2006); 16 TEX. ADMIN. CODE § 25.236(d)(1) (2007).

The SIA came into effect upon the merger of American Electric Power Company (AEP) and Central and Southwest Corp. (CSW). The SIA included a method for allocating TMRs, which it defined as the difference between "revenues collected" and out of pocket costs. In the retail rate proceeding at issue, TNC included as pre-merger TMRs

revenues from certain open transactions of its sister utilities that *had not been collected.* The result of over-stating these pre-merger revenues was that TNC would be allocated a relatively smaller percentage of the post-merger TMRs. Artificially inflating the pre-merger revenues reduced the amount that TNC would have to credit to its Texas retail ratepayers, and AEP benefited because its other subsidiaries did not have to credit retail ratepayers for off-system sales in the same manner as TNC.

The PUC determined that TNC's proposal was inconsistent with the FERC tariff—a tariff the PUC was required to implement under the filed rate doctrine. The PUC refused to give effect to the utility's flawed application of its filed rate and set the utility's retail rates in accordance with the actual terms of the FERC tariff.

The Fifth Circuit erroneously relied upon prior Court precedent, *Entergy Louisiana, Inc. v. Louisiana Public Service Commission*, 539 U.S. 39 (2003), to determine that the States are preempted from disputing a utility's construction of its wholesale rate when that construction is inconsistent with the FERC tariff. *AEP Texas N. Co. v. Texas Indus. Energy Consumers*, 474 F.3d 581, 586 (5th Cir. 2006) ("If a state disputes a utility's interpretation of a tariff, FERC is the proper forum for resolving the disagreement."). The Fifth Circuit's holding is erroneous because *Entergy* did not hold that a state regulatory agency has no authority to construe a tariff and apply its terms in state proceedings. *Entergy*, 539 U.S. at 51.

Furthermore, unlike *Entergy*, where the utility operated under an interstate system agreement that gave it discretion to determine a methodology for allocating payments among affiliates, the SIA gave no such discretion to AEP Service Corporation (AEPSC), the service agent designated by the SIA to keep track of TMRs. Here, the system agreement unequivocally provided that TMRs only included those

revenues actually collected by the utility. Nowhere in the agreement did FERC give AEPSC discretion to interpret the portion of the tariff that is at issue in this proceeding.

The Fifth Circuit's holding creates havoc for state regulatory bodies. The holding bars the States from giving effect to a filed rate. Yet that is precisely what the States are required to do. *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 962 (1986) ("interstate power rate filed with FERC or fixed by FERC must be given binding effect by state utility commissions determining intrastate rates"). The holding also upsets longstanding practice at state utility commissions. State utility commissions are routinely called upon to implement and give effect to FERC tariffs in retail rate proceedings, and the Fifth Circuit decision would effectively prevent them from examining a FERC tariff and performing that task.

Taken to its logical end, the result of the holding is that Texas must blindly accept a utility's interpretation of its filed rate, no matter how preposterous, incongruous or blatantly wrong the interpretation. If the utility claims that the FERC tariff says X, when it is indisputable that the tariff says Y, the PUC must accept the utility's interpretation, implement the erroneous rate and then seek a remedy at FERC. *See* TEX. UTIL. CODE ANN. §§ 36.102(a), 36.108(c) (Vernon 1998 & Supp. 2006) (requiring the PUC to make a final determination regarding a utility's requested rate change within 185 days or the requested retail rate change goes into effect). State retail rate proceedings involving FERC-approved multi-state agreements are common, and the Fifth Circuit's holding makes little practical sense. The opinion hamstrings Texas' ability to timely set retail rates and invites electricity market manipulation by utilities.

This Petition provides the Court the opportunity to clarify an issue left open in *Entergy*. Specifically, the Court should clarify whether a state is preempted from giving effect

to the terms of a FERC tariff when a utility asks the state to ignore those terms.

REASONS FOR GRANTING THE WRIT

I. The Court Has The Opportunity To Squarely Address Whether The States Have Authority To Reject A Utility's Request To Disregard The Terms Of FERC Wholesale Rates In A Retail Rate Proceeding

A. The PUC Order Gave Effect To FERC's Authority Over Interstate Wholesale Rates By Applying The Filed Rate

The precedent related to FERC's plenary jurisdiction to set interstate wholesale rates is well established. FERC's jurisdiction to set interstate wholesale rates is exclusive. 16 U.S.C. § 824(b) (2000 & Supp. 2007). This Court has ruled that "FERC-mandated allocations of power are binding on the States, and States must treat those allocations as fair and reasonable when determining retail rates." *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354, 371 (1988).

Similarly, the Court has held that "[o]nce FERC sets such a rate, a state may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable." *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 966 (1986). "[U]nder the filed rate doctrine, FERC-approved cost allocations between affiliated energy companies may not be subjected to reevaluation in state ratemaking proceedings." *Entergy Louisiana, Inc. v. Louisiana Pub. Serv. Comm'n*, 539 U.S. 39, 41-42 (2003). In short, the States are required to give effect to filed rates.

The PUC's Order reflects this mandate. The PUC reviewed the terms of the FERC tariff and applied its terms.

The PUC did not challenge the rate or attempt to alter any allocation. Rather, the PUC examined the utility's calculation of revenues from its off-system sales and, as required by the SIA, refused to include certain "base year" revenues that had not actually been collected.[2] The PUC logically and reasonably determined that the definition of TMRs stated in the tariff was not reconcilable with AEPSC's method of using "mark to market accounting" to calculate base year revenues from off-system sales.

The PUC's Order gave effect to the FERC tariff because the SIA itself explicitly defined TMRs as "the difference between i) the *revenues collected* from Trading and Marketing Activities and ii) Out-of-Pocket Cost of such Trading and Marketing Activities and any transmission cost related to such activities." (emphasis added) "Mark-to-market" accounting, on the other hand, is an accounting method by which assets are recorded at their current market value, which may be higher or lower than their actual purchase price or book value. The accounting method looks at the market price rather than the revenues actually collected by the utility for the trading activities.

The effect of using this accounting scheme was that AEP East's base year margins were inflated by including open

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[2] The SIA formula provided that TMR margins were to be allocated between AEP East and AEP West up to the level of realizations achieved in a "base year" (the pre-merger period of July 1999 through June 2000). AEP East's and AEP West's relative percentage of total TMRs from off-system sales established a "base year allocation." Any TMRs in excess of the level of realizations achieved in the base year were to be shared according to the ratio of owned generating capacity in the two zones. TNC and other former CSW companies that merged with AEP were in AEP West.

transactions that had not actually closed during the base year. This is significant because the tariff required TMRs to be allocated, in part, based on off-system sales margins during the base year. The parties in the reconciliation proceeding stipulated that the accounting scheme resulted in $7.9 million less in revenues for TNC than would have resulted if the base year revenues were calculated using only revenues actually collected. *AEP Texas N. Co. v. Texas Indus. Energy Consumers*, 474 F.3d 581, 583 (5th Cir. 2006). The PUC then applied the terms of the SIA and duly determined that the utility's retail rates should be reduced to reflect the $7.9 million.

B. The Fifth Circuit Erroneously Ruled That The PUC's Order Was Preempted

The Fifth Circuit erroneously ruled that the PUC was preempted from determining that the utility's application as filed was inconsistent with the FERC tariff at issue. *AEP Texas*, 473 F.3d at 586. Relying primarily on *Entergy*, the Fifth Circuit held that because the SIA authorized AEPSC to implement the formula for calculating TMRs, it granted AEPSC discretion to interpret what "revenues collected" during the pre-merger period meant. *AEP Texas*, 473 F.3d at 585.

This is faulty logic. Nowhere in the agreement was AEPSC granted authority to do anything other than input data to comply with the formula. And nowhere in the SIA was AEPSC authorized to calculate the base year allocation, the portion of the tariff at issue in this case. Indeed it would be odd for the agreement to have granted AEPSC such discretion since the base year allocation is based on transactions that occurred prior to the AEP-CSW merger and prior to the effective date of the SIA.

The Fifth Circuit overstepped the ruling in *Entergy*. In *Entergy*, the Court rejected the Louisiana Public Service

Commission's (LPSC) argument that, because FERC had not determined how certain generating units would be classified for purposes of making capacity payments among affiliates, LPSC had authority to second-guess the utility's methodology. *Entergy*, 539 U.S. at 50. The Court disagreed. The Court stated that "[i]t matters not whether FERC has spoken on the precise classification of ERS units, but only whether the FERC tariff dictates how and by whom that classification should be made." *Id.*

This ruling cannot stand for the proposition that a service agent that has been named to keep track of revenues has carte blanche to ignore *how* the tariff says they are to be calculated. Multi-state system agreements typically have a utility affiliate that acts as a service agent. This arrangement makes sense because implementation of the tariff requires access to the utility's books and access to confidential and proprietary business information. But the service agent must still implement the terms of a tariff. *Entergy* cannot mean that the naming of a service agent to apply a formula is tantamount to giving that agent discretion to compel a state commission to disregard *Nantahala's* directive to give effect to FERC-approved tariffs.

Furthermore, the facts of *Entergy* are distinguishable from the situation at bar. In *Entergy*, the Court addressed a state commission's authority to challenge the reasonableness of a utility's cost allocation under a system agreement where the FERC tariff granted the utility discretion to interpret the agreement. The Court held that "a FERC tariff that delegates discretion to the regulated entity to determine the precise cost allocation similarly pre-empts an order that adjudges those costs imprudent." *Entergy*, 539 U.S. at 42. In *Entergy*, the utility was given discretion to determine whether certain units were considered available capacity when calculating affiliate expenses for capacity. Here, AEPSC was not granted similar discretion. The terms of the SIA were

explicit that the base year allocation was to be based on revenues that had been collected—not hypothetical forecasts of revenues.

Because TNC proposed to calculate base year revenues in a manner that disregarded the FERC tariff, the need to clarify the holding in *Entergy* arises. In *Entergy*, the Court left open "the question of the exclusivity of FERC's jurisdiction to determine whether and when a filed rate has been violated." *Entergy*, 539 U.S. at 51. In the instant case, the Fifth Circuit has held that "pursuant to the filed rate doctrine, federal law preempts state regulators from making a final determination as to whether a FERC tariff has been violated and from imposing a remedy for the alleged violation." *AEP Texas*, 473 F.3d at 582. What the Fifth Circuit has done is to strip the States of authority to give effect to a federal tariff. This cannot be the intent of *Entergy*.

II. The Fifth Circuit's Holding Prohibits State Commissions From Giving Effect To Filed Rates In Retail Rate Proceedings

State commissions are routinely called upon to apply FERC tariffs in state ratemaking proceedings. Implementation of FERC wholesale rates in a state fuel reconciliation proceeding is one example. Texas law requires a regulated utility to periodically reconcile its fuel costs and revenues. 16 TEX. ADMIN. CODE § 25.236 (2007). If a utility under-recovers its fuel costs and expenses, ratepayers must pay back the utility in fuel surcharges. Likewise, if a utility over-recovers its fuel costs and expenses, the utility must issue refunds to its ratepayers. Determination of wholesale power costs and margins is necessary to determine a utility's fuel costs. Implementing FERC tariffs is also necessary in state proceedings to set

retail base rates.[3] *See* TEX. UTIL. CODE ANN. § 36.001 (Vernon 1998 & Supp. 2006).

The States have a duty to honor FERC tariffs under well-established precedent. *Natanhala*, 476 U.S. at 966 (requiring that States must "give effect" to interstate wholesale rates); *Montana-Dakota Utils. Co. v. Nw. Pub. Serv. Co.*, 341 U.S. 246 (1951) ("No tribunal may enter an order that would have the effect of "authoriz[ing] commerce in the commodity on other terms."). It cannot be the case that federal preemption with respect to interstate wholesale rates absolves the States of the duty to honor filed rates. But that is the effect of the Fifth Circuit holding. The lower court held that "[i]f a state disputes a utility's interpretation of a tariff, FERC is the proper forum for resolving the disagreements." *AEP Texas*, 473 F.3d at 586 (citing *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354, 375 (1988) (MP&L)). In the meantime, the States, which must timely act on retail rate change proceedings, must disregard the express terms of the tariff, in violation of *Natanhala*.

The Fifth Circuit's blanket ruling goes too far, and its reliance on *MP&L* is misplaced. In *MP&L*, the Court addressed whether the States could inquire into the prudence of a purchase where the reasonableness of the rates and agreement related to the purchase had been approved by FERC. The Court held: "The reasonableness of rates and agreements by FERC may not be collaterally attacked in state or federal courts. The only appropriate forum for such a challenge is before the Commission or a court reviewing the Commission's order." *MP&L*, 487 U.S. at 375.

The Petition does not present a reasonableness challenge to a FERC-approved tariff. Indeed, the Petition does not

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[3] "Base rates" generally cover all of a utility's costs other than fuel.

present a challenge to a FERC tariff at all. What the Petition presents is an opportunity for the Court to clarify whether the States have authority to implement the terms of FERC tariffs in retail rate proceedings, even where the utility has asked the state to disregard the terms of the FERC tariff. If the States do not have this authority, then the logical result is that a utility whose retail rates recover costs set in a FERC wholesale rate (as is typically the case) can require a state commission to implement a retail rate increase that violates the terms of its wholesale rate.

Examining what happens if this were to occur illustrates the consequences of the Fifth Circuit's ruling. The PUC is required by Texas law to make a final determination regarding a utility's requested base rate change within 185 days *or the requested retail rate change goes into effect.* TEX. UTIL. CODE ANN. §§ 36.102(a), 36.108(c) (Vernon 1998 & Supp. 2006). Assume that a FERC tariff provides that Texas ratepayers must pay $10 per kilowatt for wholesale power. Assume that the utility (which has the responsibility of calculating and keeping track of its power purchases) claims that Texas ratepayers should pay $10,000 per kilowatt. After discovery and cross-examination at a contested hearing, the parties to the retail rate proceeding discover the error. The utility refuses to acknowledge the error, and tells the PUC that, if it does not like its application, it can complain to FERC after it issues a final order.

The Fifth Circuit's ruling gives the States an unworkable remedy to a proposed violation of a filed rate. The PUC cannot apply a rate that runs afoul of the FERC tariff. Yet the PUC must rule on the application that proposed the violation of the filed rate within 185 days or the proposed rates go into effect. The Fifth Circuit's holding would require the PUC to allow the erroneous rate to go into effect, and then seek a remedy at FERC under the Federal Power Act. 16 U.S.C. § 825e (2000 & Supp. 2007). This places an

unreasonable burden and procedural hardship on the States, as well as regulated ratepayers who would be forced to pay higher rates based on the utility's misapplication of its filed rate.

If the States were to misapply the terms of a FERC tariff, a utility is not without a remedy. FERC is the ultimate arbiter of its wholesale tariffs. The utility has several options if it disagrees with the application of a tariff. The utility may seek a declaratory order from FERC regarding the meaning of the tariff. *California v. Fed. Energy Regulatory Comm'n*, 495 U.S. 490, 495 (1990); 18 C.F.R. § 385.207 (2007). If FERC decides in the utility's favor, FERC has authority under the Federal Power Act to bring an action in the proper District Court to enjoin the States' action. 16 U.S.C. § 825m (2000 & Supp. 2007). The utility may also, as it did here, seek to enjoin the Commission's order in a United States District Court of competent jurisdiction in order to prevent the PUC's application of its rate from going into effect.

Placing the burden on the States to enforce the terms of FERC tariffs, but giving them no authority to reject a utility's proposal that is inconsistent with those terms, makes little sense. The Fifth Circuit's ruling that the States must knowingly ignore the terms of a FERC tariff in a retail rate proceeding whenever a utility asks them to should be reversed.

CONCLUSION

The PUC's Petition For Writ Of Certiorari should be granted. The Court may wish to consider summary reversal.

Respectfully submitted,

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IN THE

Supreme Court of the United States

PAUL HUDSON, *et al.*,

Petitioners,

v.

AEP TEXAS NORTH COMPANY, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF IN OPPOSITION FOR RESPONDENT AEP TEXAS NORTH COMPANY

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QUESTION PRESENTED

Whether the court below correctly applied this Court's analytic framework for federal preemption in state retail ratemaking in a multi-state power system, as set forth in *Entergy Louisiana, Inc. v. Louisiana Public Service Commission*, 539 U.S. 39 (2003), *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988), and *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986).

RULE 29.6 STATEMENT

Respondent AEP Texas North Company is a wholly-owned subsidiary of AEP Utilities, Inc., which in turn is a wholly-owned subsidiary of American Electric Power Company, Inc. No publicly held company owns 10% or more of American Electric Power Company.

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The petition raises the question of whether a state regulatory body, in seeking to lower retail rates, can overrule the allocation decisions made by an agent of a multi-state holding company pursuant to a federal tariff. This Court recently answered that question in *Entergy Louisiana, Inc. v. Louisiana Public Service Commission*, 539 U.S. 39 (2003). This petition does not raise any circuit conflict, and it rests on a legal theory — primary jurisdiction — that was not raised below. For these and other reasons discussed more fully in this opposition, Respondent AEP Texas North Company submits that the petition should be denied.

STATEMENT

A. AEP Multi-State System

AEP Texas North Company (TNC) is one of nine public utilities owned by the American Electric Power Company, Inc. (AEP), a multi-state power system. Appendix (App.) 2. TNC provides retail electric service in the State of Texas, but it shares in certain benefits of generation capacity owned and operated by its affiliates in ten other states. App. 2, 11.

When the AEP system has an excess of generating capacity, AEP Service Corporation (AEPSC) sells the power at wholesale to other utilities. App. 2. AEPSC then allocates the profits (called TMRs) derived from these sales between the two zones in the AEP system, AEP-East and AEP-West. App. 2, 12.[1] Such allocations are governed by the System Integration Agreement (SIA), a rate schedule filed with and

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[1] TMR is the acronym for Trading and Marketing Realization. Generally speaking, TMRs represent the net revenues from off-system sales to a non-AEP company. App. 2.

approved by the Federal Energy Regulatory Commission (FERC). App. 2-3, 11.[2]

The SIA designates AEPSC as the "agent" and prescribes a formula for AEPSC to use in making the allocations. App. 2-3, 12. The first stage is based on the ratio of AEP-West margins to AEP-East margins in the "Base Year" (July 1999 to June 2000). Transactions are allocated on this ratio until the "Base Year" level of margins is reached. The second tier consists of all TMRs after the "Base Year" margins are reached. Under the second tier, all additional margins are divided between the AEP-East and AEP-West zones according to their relative ownership of generating capacity. App. 3.

AEPSC's allocations are subject to review by FERC. Under the Federal Power Act, FERC is charged with regulating the sale of electricity at wholesale in interstate commerce. 16 U.S.C. § 824(b). In this capacity, FERC is to ensure that wholesale rates and practices are reasonable. *See* 16 U.S.C. § 824d. It has investigation and refund powers. 16 U.S.C. § 824e.

B. The Texas Retail Rate Proceeding

The Public Utility Commission of Texas (PUCT) did not file a complaint with FERC. The PUCT also has no jurisdiction over AEPSC. App. 20. Nevertheless, the PUCT

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[2] *See Am. Elec. Power Co. & Cent. & S.W. Corp.*, 90 FERC ¶ 61,242, at 61,799 (2000) ("We find that the SIA . . . [is] just and reasonable."), *aff'd, Wabash Valley Power Ass'n v. FERC*, 268 F.3d 1105, 1114 (D.C. Cir. 2001).

decided to examine AEPSC's allocations under the SIA when fixing TNC's state-jurisdictional retail rates.[3]

TNC argued that the state's inquiry was preempted under the Federal Power Act. Resp. App. 4a-5a. The PUCT, however, adopted the finding of the Administrative Law Judges (ALJs) that there was no federal preemption here because the PUCT retains jurisdiction to evaluate the "prudence" of all transactions subject to accounting under the SIA. Resp. App. 12a-15a, 17a.

TNC alternatively presented expert testimony in support of AEPSC's allocations. TNC's expert explained that AEP's books and records were kept in accordance with FERC's Uniform System of Accounts and with generally accepted accounting principles (GAAP).[4] AEPSC had recorded the value of open energy trades using the mark-to-market (MTM) methodology set out in the guidance of the Financial Accounting Standards Board (FASB) applicable at the time. In particular, a FASB task force — consisting of representatives of public accounting firms and the chief accountant of the SEC — had reached a consensus that energy trading contracts should be marked to market, with

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[3] The PUCT no longer has exclusive authority to regulate retail rates in most parts of Texas. In 2002, Texas moved to a deregulated electricity market. *See* Tex. Util. Code Ann. §§ 39.001 – 39.910 (Vernon 2007). Thus, the rate review procedures followed in this case no longer apply to retail rates today in most of Texas including the territory served by TNC. App. 3.

[4] This testimony of Timothy Trumpler is available at http://www.puc.state.tx.us/interchange/index.cfm, Control No. 26000, Item No. 219 (Nov. 5, 2002).

gains and losses included in earnings and separately disclosed in the financial statements. AEP had adopted mark-to-market accounting to comply with GAAP, and had used this measure of revenues — as reflected on its books — as the basis for the Base Year allocation.

The PUCT initially found that AEPSC correctly calculated the allocations in accordance with the SIA. App. 3; Resp. App. 18a. In this respect, the PUCT agreed with the panel of Administrative Law Judges (ALJs) in this case. The ALJs had reasoned that the allocation of realizations under the SIA was "quite generalized" and thought that the "rather loose structure of the SIA" gave them warrant to examine the margins. Resp. App. 11a-12a. The ALJs acknowledged that TNC had presented "evidence that [AEPSC's] inclusion of the market values of 'open positions' and its use of MTM methodology in calculating Base Year margin levels was an accepted industry practice, supported by contemporary guidance from the Financial Accounting Standards Board, at the time the calculations were performed." Resp. App. 14a. Other parties had "provided no actual evidence to rebut" TNC's position. *Id.* "The record thus supports a finding that [AEPSC] adequately calculated the applicable Base Year margin levels." *Id.*

On rehearing, however, the PUCT reversed itself and adopted a different interpretation of the SIA. The PUCT "found that [TNC's] affiliate American Electric Power Service Company (AEPSC) inappropriately included the 'mark-to-market' based value of open transactions in determining the energy trading margins contributed by the AEP East operating companies in the base year of July 1, 1999-June 30, 2000." Resp. App. 20a. The PUCT found that AEPSC, by including the mark-to-market value, had

overstated AEP-East's share of TMRs and under-stated AEP-West's portion. *Id.*[5]

The PUCT then forced TNC to bear the financial consequences of AEPSC's alleged error. Because, in the PUCT's view, AEPSC should have allocated approximately $7.9 million more in TMRs to TNC, TNC's recovery of eligible fuel costs would be reduced by this amount. App. 32. In reality, TNC had not received the $7.9 million. Thus, the PUCT forced TNC to absorb the difference between what AEPSC actually allocated to it under the SIA and what the PUCT believed should have been allocated.

TNC sought rehearing, repeating its argument that state jurisdiction over the SIA's allocations was preempted. The PUCT denied the rehearing requests in November 2004. App. 4.

C. District Court Proceeding

TNC filed a complaint against the Commissioners of the PUCT in federal court pursuant to 28 U.S.C. § 1331 (2000). App. 4. TNC alleged, *inter alia*, that the PUCT's attempt to re-allocate TMRs violated the Supremacy Clause and the Federal Power Act in several different ways. TNC explained that the PUCT had interfered with FERC's exclusive authority to interpret and enforce a federal tariff, and also unlawfully "trapped" TNC's costs. The PUCT filed an Answer; several Texas cities and an association of large industrial consumers intervened.

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[5] *See also* App. 30-31 (Order on Rehearing). Contrary to the order below, petitioners and their amicus seem to suggest to this Court that it was TNC, rather than AEPSC, who made the allocations. *E.g.*, NARUC Amicus Br. 6. This is incorrect. *See* Resp. App. 20a.

The parties filed cross motions for summary judgment. App. 16. The PUCT never mentioned the doctrine of primary jurisdiction. Instead of arguing that FERC has "primary jurisdiction," the PUCT acknowledged that FERC has "exclusive jurisdiction" to regulate interstate wholesale power rates. App. 17.[6] The PUCT's theory was that it had to apply the SIA's "plain language" under the filed-rate doctrine. The PUCT argued that AEPSC's use of mark-to-market accounting was contrary to the SIA's plain language and barred by the filed rate doctrine.[7] However, the PUCT conceded in supplemental briefing and at oral argument that the SIA "says nothing about AEP's use of a particular accounting methodology" to account for these TMRs.[8]

D. The District Court's Decision

The district court granted summary judgment in favor of TNC. *AEP Texas North Co. v. Hudson*, 389 F. Supp. 2d 759 (W.D. Tex. 2005) (App. 10-23). The district court applied the preemption analysis set forth in *Entergy*.

The district court observed that, under *Entergy*, "'[i]t matters . . . only whether the FERC tariff dictates how and by whom that classification should be made.'" App. 19 (*quoting Entergy*, 539 U.S. at 50). The court found that the two-prongs of this test were satisfied here. The "SIA designates AEPSC to centrally calculate TMRs" and "also sets forth a process for making such allocations." App. 19.

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[6] *See also* Commissioners' Response and Cross-Motion for Summary Judgment, at 2, 6, 8 (filed Apr. 1, 2005).

[7] *See id.* at 8-10.

[8] Commissioners' Supplemental Brief, at 3 (filed Nov. 1, 2002).

The district court rejected the PUCT's "plain language" argument. "[T]he omission of AEPSC's use of a particular accounting methodology must be interpreted to grant deference to AEPSC to choose the accounting methodology it will use to allocate the TMRs." App. 20. The court separately found that the "plain language" argument failed because "the PUC has no jurisdiction over AEPSC that makes the calculations under SIA" and the SIA itself "expressly grant[s] jurisdiction to review AEPSC's allocation methodology with FERC." App. 20 nn.6 & 7. "Therefore, the Commissioners must accept AEPSC's allocation . . . unless and until FERC says otherwise." App. 20.

E. The Fifth Circuit's Decision

On appeal, the PUCT still did not mention the doctrine of primary jurisdiction. The PUCT recognized that this Court's decisions "prohibit second-guessing of FERC-filed rates" but claimed that no such "second-guessing" occurred here because the tariff's plain language compelled only one reading.[9] The PUCT argued that this case was different from *Entergy* because "the utility in that case had not deviated from the allocation method specified in its tariff, as TNC has in this case."[10]

A unanimous Fifth Circuit panel affirmed the district court. *AEP Texas North Co. v. Texas Indus. Energy Consumers*, 473 F.3d 581 (5th Cir. 2006) (Reavley, Stewart, Clement, J.J.) (App. 1-9).

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[9] Brief of Appellants Commissioners of the Public Utility of Texas, at 10-11 (filed Apr. 19, 2006).

[10] *Id.* at 11.

The court began by recognizing that FERC has "exclusive jurisdiction" over wholesale rates. App. 4. It was the need to enforce FERC's "exclusive jurisdiction" over all elements of wholesale ratemaking that led this Court to develop the "filed rate doctrine" and to hold that states are preempted from "second-guessing FERC's allocations . . . conducting prudence inquiries, . . . [and] 'trapping costs' . . . ." App. 4-5 (citing *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953, 962 (1986) (*Nantahala*) and *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988) (*MP&L*)).

The Fifth Circuit then found that this Court recently applied the same principles to preempt state review of cost allocations within a multi-state system in *Entergy*, 539 U.S. at 49-50. App. 5-7. The court recognized *Entergy* did not address a state's power to interpret the federal tariff. App. 7. However, the court found that the PUCT's "plain language" argument failed under earlier precedent for three different reasons.

First, the Fifth Circuit quoted the Court's ruling in *MP&L* that "'States may not regulate in areas where FERC has properly exercised jurisdiction . . . .'" App. 8 n.16. Accordingly, the Fifth Circuit ruled that "states are bound to implement a FERC-approved agreement, and the agreement authorizes only AEPSC to implement the formula." App. 7-8.

Second, and again relying on *MP&L*, the Fifth Circuit recognized that "FERC, not the state, is the appropriate arbitrator of any disputes involving a tariff's interpretation." App. 8. The Federal Power Act gives FERC exclusive jurisdiction to regulate wholesale rates, and "it is FERC's duty under the FPA to make an assessment of the broad public interest involved in determining interstate rates." App. 8 (*citing* 16 U.S.C. § 824(a)). Congress designed the

FPA to have these multi-state disputes settled by one national arbiter (FERC) with exclusive jurisdiction — not by different states, each of which could claim that its own interpretation is correct. "If each state could enforce its own findings as to the meaning of the filed rate, in opposition to the conclusion of a FERC-approved agent, the conflicting interpretations would undermine FERC's ability to ensure that a filed rate is uniform across different states, and intrude upon its exclusive jurisdiction over interstate power transactions." App. 8-9.

Third, the Fifth Circuit recognized an independent problem with the PUCT's position: "the FPA gives FERC exclusive jurisdiction to remedy tariff violations by providing refunds." App. 9 (*citing* 16 U.S.C. § 824e). The states have authority over retail rates and the local utility only, and they cannot effectuate the change in allocations across the entire system. Conflicting state orders result in the same trapping of costs that the Supreme Court's decisions prohibit. "If states could remedy perceived violations by setting retail rates based on their own calculations, states could potentially 'trap' costs by prohibiting the utility from passing on the price of FERC-mandated rates to consumers." App. 9 (*citing MP&L*).

The PUCT filed for rehearing and rehearing en banc, raising the same arguments but not mentioning the doctrine of primary jurisdiction. On January 26, 2007, the Fifth Circuit denied the rehearing request. App. 26. No panel member nor judge in regular active service requested that the court be polled. *Id.*

REASONS FOR DENYING THE PETITION

The unanimous opinion of the Fifth Circuit was in complete accord with this Court's most recent decision on federal preemption in *Entergy*. The Fifth Circuit's decision is not in conflict with any decision of this Court or any lower

court. The theories presented in this petition, such as primary jurisdiction, were not presented to or adopted by the PUCT below and in any event do not warrant a different result here. Review by this Court is not warranted.

I. The Decision Below Does Not Conflict With This Court's Decisions

A. The Court Below Correctly Applied *Entergy*, *MP&L*, and *Nantahala*

The petition raises a question that has been soundly answered by the Fifth Circuit on the basis of existing precedent. In a series of cases decided over three decades, this Court has held that state regulators may not overrule allocations made pursuant to multi-state federal tariffs.[11] This Court has applied this principle to allocations of both burdens and benefits.[12] The Court has reasoned that state review would frustrate FERC's exclusive jurisdiction by trapping costs at the retail level.[13] The Court has insisted on

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[11] *See Entergy*, 539 U.S. at 41-42 ("FERC-approved cost allocations between affiliated energy companies may not be subjected to reevaluation in state ratemaking proceedings."); *see also MP&L*, 487 U.S. at 371; *Nantahala*, 476 U.S. at 962-73.

[12] *See Entergy*, 539 U.S. at 47-50 (allocation of cost equalization payments); *MP&L*, 487 U.S. at 360 (allocation of power costs); *Nantahala*, 476 U.S. 956 (allocation of low-cost power).

[13] *Entergy*, 539 U.S. at 49-50; *MP&L*, 487 U.S. at 372-73; *Nantahala*, 476 U.S. at 970 ("Here, Nantahala cannot fully recover its costs of purchasing at the FERC-approved rate if NCUC's order is allowed to stand.").

federal preemption both when FERC has spoken to the precise issue and when it has not.[14] Most recently, in the *Entergy* case, this Court has held that state regulators may not even exercise their powers over prudence at the retail level to upset an allocation made by a designated agent exercising discretion under a multi-state tariff. *See Entergy*, 539 U.S. at 49-50.

In the retail rate proceeding, the PUCT relied upon the same "prudence" theory that was rejected in *Entergy*. Resp. App. 13a-15a, 17a. In federal court, the PUCT developed a different preemption theory. It has argued that the impact of *Entergy* can be avoided through a claim that it was interpreting or enforcing the federal tariff. App. 7; Petition at 6. The PUCT notes that, in *Entergy*, this Court said: "we have no occasion to address the question of the exclusivity of FERC's jurisdiction to determine whether and when a filed rate has been violated." *Entergy*, 539 U.S. at 51.

The Court, however, remarked that it was "curious[]" for the state regulators to advance this argument because their order below reached the exact opposite conclusion. *Id.* at 50. The order below found the state regulators were "'pre-empted from determining whether the terms of a FERC tariff have been met, for the issue of violation of or compliance with a FERC tariff is peculiarly within FERC's purview.'" 539 U.S. at 45 (*quoting* the state commission decision).[15] In

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[14] *See Entergy*, 539 U.S. at 50 ("It matters not whether FERC has spoken to the precise classification of ERS units . . . ."); *MP&L*, 487 U.S. at 375-77.

[15] The Louisiana Public Service Commission also said: "Any allegation of a violation of a FERC-tariff should therefore be brought before the FERC." *Re: Louisiana*

(Continued ...)

other words, the state commission in *Entergy* recognized that it had no jurisdiction under governing law to interpret a federal tariff.

Here, the Fifth Circuit held that the PUCT's theory was foreclosed by existing law. The court distilled three fundamental principles from this Court's earlier opinions. The petition in this case does not address any of these principles.

The first principle is that a "bright line" exists between state and federal jurisdiction, making a case-by-case analysis unnecessary. *Nantahala*, 476 U.S. at 986 (*quoting Fed. Power Comm'n v. S. Cal. Edison Co.*, 376 U.S. 205, 214-16 (1964)). "There can be no divided authority over interstate commerce . . . ." *MP&L*, 487 U.S. at 377 (quotations and citation omitted). The interpretation of a federal tariff is a quintessential function of FERC, which must understand the meaning of a tariff in order to judge its reasonableness. "A tariff is not an abstraction . . . . Complex and technical cost allocation and accounting problems must be solved in setting the tariff initially." *United States v. W. Pac. R.R.*, 352 U.S. 59, 66 (1956). It is precisely the province of FERC to ensure that the resulting rate or allocation is just and reasonable, and it may take into account any competing policy interests of the FPA when choosing between permissible constructions. "States may not alter FERC-ordered allocations of power by substituting their own determinations of what would be just and fair." *MP&L*, 487 U.S. at 371. Here, the PUCT argues for concurrent regulatory jurisdiction and ignores altogether the bright line approach adopted by this Court.

Power & Light Co., Docket No. U-20925, 1998 WL 1285300, at *18 (La. P.S.C. Dec. 22, 1998).

The second principle is that the assignment of exclusive authority to FERC is essential to protect the interests of all States. Congress enacted the FPA because it recognized that the "production and transmission of energy" is "particularly likely to affect more than one State," and that "uncontrolled [state] regulation" can "patently interfere with broader national interests." *Arkansas Elec. Coop. Corp. v. Arkansas Pub. Serv. Comm'n*, 461 U.S. 375, 377 (1983). The FPA prevents this interference with interstate commerce by centralizing all decisions about wholesale power arrangements in a single federal forum — FERC — and by establishing a uniform, orderly procedure in which all legitimate state interests in such arrangements can be raised and considered. In the case of allocations of costs or revenues under a multi-state tariff, the need for a neutral forum is self-evident. The Court has accordingly upheld exclusive federal jurisdiction in such cases. *See Entergy*, 539 U.S. at 42-43; *MP&L*, 487 U.S. at 371; *Nantahala*, 476 U.S. 962-73. Again, the petition does not explain how any single state could provide a neutral forum for resolution of disputes arising under such tariffs.

The third principle is that the only way to assure the utility recovers a hundred percent of its costs is for all states to adhere to a uniform interpretation. This Court's decisions in *Nantahala*, *MP&L* and *Entergy* recognize that costs will inevitably be trapped when each state imposes its own allocation in a multi-state system. *Entergy*, 539 U.S. at 49-50; *Nantahala*, 476 U.S. at 966-70; *MP&L*, 487 U.S. at 377. No state can effectuate its own change in allocations across the entire system. As applied here, the AEP operating system could be caught in a squeeze where each state allocates more profits or TMRs to its own jurisdiction, thereby preventing the AEP system from fully recovering its costs. Again, the petition does not address the Fifth Circuit's concern with the lack of a complete remedy in an individual state and

consequent risk of trapped costs under the controlling federal tariff.

Petitioners recognize that "[d]etermining prudence or reasonableness is a matter inherent in the setting of [federal] rates." Petition at 15. Petitioners fail to recognize, however, that the exercise of state retail jurisdiction to find a "violation" of a federally-approved, multi-state wholesale tariff raises all the same concerns as the exercise of "prudence" jurisdiction to overrule a cost allocation in similar circumstances. In either case, the individual state commission acts with regard to the interests of its own retail customers; its interpretation can easily conflict with those of other states, having opposing interests. The individual state commission is not in a position to grant a complete remedy, because it does have the other subsidiaries and regulators before it. Thus, its direction can easily compel the regulated entity to "trap costs" between wholesale and retail rates or, as here, lower its retail prices to reflect revenues that it does not really have.

This kind of parochial state regulatory action is no more justifiable when cast in terms of finding a "violation" of the federal tariff than in terms of finding a "prudence" violation. State regulators have no identifiable mandate to enforce federal tariffs, to find violations of them, or to provide remedies for violations of federal tariffs. The federal tariffs govern wholesale, interstate transactions, where States have no jurisdiction. FERC has the authoritative role in interpreting and enforcing federal tariffs, at least where they touch multiple states. "'[W]hether one characterizes the questions as related to prudence, interpretation [of the basic system agreements], or cost allocation, they are clearly matters most appropriately resolved by this Commission as part of its overriding authority to evaluate and implement all applicable wholesale rate schedules.'" *MP&L*, 487 U.S. at 378 (Scalia, J., concurring in the judgment) (alternation in

original) (*quoting AEP Generating Co.*, 36 FERC ¶ 61,226, at 61,550 (1986)).

Petitioners do not address the Fifth Circuit's reasons for finding no state jurisdiction to interpret federal tariffs, but they do challenge that court's reliance on *Entergy*. Petitioners argue that AEPSC, unlike the allocation agent in *Entergy*, had no discretion in making the allocations that are the subject of this case. In the view of petitioners and their *amici*, the language of the SIA is so plain and precise that any interpretation other than their own current interpretation — forbidding mark-to-market accounting — is a "violation" of the tariff.

This "plain meaning" argument is surprising, in that the use of mark-to-market accounting to calculate Base Year revenues was approved first by the panel of ALJs who heard the evidence, and then by the PUCT itself in its initial decision, which adopted the ALJs' reasoning. Resp. App. 14a, 18a. The PUCT's own change of mind demonstrates that the language of the SIA — which the ALJs saw as "quite generalized" (Resp. App. 11a) — is sufficiently ambiguous to permit this approach.

Further, this point has already been decided against Petitioners in the courts below. The district court observed, "[T]he omission of AEPSC's use of a particular accounting methodology must be interpreted to grant deference to AEPSC to choose the accounting methodology it will use to allocate the TMRs." App. 19. The court of appeals did not disagree. The court of appeals emphasized the parallel to the *Entergy* case, where this Court faced a different question of interpretation under a tariff — whether certain units could be classified as "available" when those units were actually shut down, but could be activated in emergencies. *See* App. 6 (*discussing Entergy* decision). This Court treated the ambiguity in the agreement as "leav[ing] the classification of

ERS units to the discretion of the operating committee . . . ." *Entergy*, 539 U.S. at 49.

By the same token, AEPSC was free to decide what accounting methodology best reflected the revenues associated with off-system trading. A holding company must make a whole range of decisions in allocating burdens and profits among subsidiaries. Under the SIA, those decisions included not only out of pocket costs and revenues, but also the ratio of owned generating capacity of each member of the system at a given point in time — precisely the issue before this Court in *Entergy*. If multiple state agencies were free to overrule holding company decisions on each such issue based on what they viewed as "plain" language, this Court's *Entergy* decision would become essentially meaningless. In any event, the question of whether this particular agreement vested the AEPSC with discretion to decide the accounting methodology is not a sufficiently broad one for this Court to decide.[16]

B. The Decision Below Does Not Conflict With This Court's Earlier Decisions

Seeking to avoid the compelling logic of this Court's decisions dealing directly with multi-state, multi-party tariffs, the petitioner reaches back to an older set of decisions dealing with tariffs as contracts between two parties. These cases do not involve state regulatory agencies setting retail rates on the basis of their views of appropriate wholesale rates or allocations. Rather, they arise from the judicial

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[16] An alleged misapplication of a correct legal standard to a particular case does not ordinarily merit review by this Court. *See* Sup. Ct. R. 10 ("A petition for a writ of certiorari is rarely granted when the asserted error consists of * * * the misapplication of a properly stated rule of law.").

enforcement of tariffs as contracts. Since the courts may play a role in such enforcement, they have retained jurisdiction over the contract claims, but have acknowledged the primary jurisdiction of the federal Commission with respect to any issues of tariff interpretation that implicate administrative discretion, specialized knowledge or concerns about uniformity.

Thus, in the 85 year-old *Great Northern Railway v. Merchants' Elevator Co.*, 259 U.S. 285 (1922), the Court held that a state court hearing a contract claim could hear an issue of tariff interpretation when it presented "a question solely of law." *Id.* at 291. However, the Court recognized that "preliminary resort to the [ICC] Commission" would be required in cases where the "inquiry is essentially one of fact and of discretion in technical matters; and uniformity can be secured only if its determination is left to the Commission." *Id; see also id.* at 295 n.2 (collecting cases in which the "question presented either was one of fact or called for the exercise of administrative discretion.").

The Court confirmed this analysis in *United States v. Western Pacific Railroad*, 352 U.S. 59 (1956). There, although neither party had raised any jurisdictional issue, the Court raised the question of primary jurisdiction sua sponte and concluded that the ICC should decide in the first instance the question of tariff interpretation raised there. The Court explained that the *Great Northern* case had made clear that "where words in a tariff are used in a peculiar or technical sense, and where extrinsic evidence is necessary to determine their meaning or proper application . . . then the issue of tariff application must first go to the Commission." *Id.* at 66.

This framework for the exercise of primary jurisdiction in contract cases was not modified, but reaffirmed in *Pan American Petroleum Corp. v. Superior Court*, 366 U.S. 656 (1961), cited in the Petition at 12. There, the applicable rate had been established in prior litigation before this Court.

Cities Serv. Gas Co. v. State Corp. Comm'n., 355 U.S. 391 (1958). The Court therefore allowed suits for overcharges on the contracts to proceed in state court. It reaffirmed the criteria used in the *Great Northern* Case for identifying issues to be sent to the Commission.

In light of these and other precedents, FERC has announced a three-part test for primary jurisdiction:

> (1) whether [FERC] possesses some special expertise which makes the case peculiarly appropriate for [FERC] decision; (2) whether there is a need for uniformity of interpretation of the type of question raised by the dispute; and, (3) whether the case is important in relation to the regulatory responsibilities of [FERC].

Arkansas Louisiana Gas Co. v. Hall, 7 FERC ¶ 61,175, at 61,322 (1979). It is this test that FERC has applied in the decisions cited by PUCT, when it has allowed relatively simple issues of contract interpretation between two parties to be addressed in court. *City of Glendale v. Portland Gen. Elec. Co.*, 115 FERC ¶ 61,231 (2006); *Kentucky Utils. Co.*, 110 FERC ¶ 61,285 (2005).

None of this primary jurisdiction case law cited by the PUCT provides any reason to grant this petition. In the first place, the question of primary jurisdiction was not raised before the PUCT, in the district court, or even in the court of appeals. The use of a primary jurisdiction framework to resolve this case is therefore waived. *See TRW Inc. v. Andrews*, 534 U.S. 19, 34 (2001) (issue waived "because it was not raised or briefed below"). At a minimum, given the lack of consideration of this point in the various tribunals below, this case provides an extraordinarily poor vehicle in which to consider jurisdictional options.

Second, the primary jurisdiction case law cited by the PUCT demonstrates exactly why FERC must have exclusive

jurisdiction over this issue. This is not simply a contract dispute between two parties, but a question of allocation under a regional tariff in which multiple subsidiaries in multiple states are implicated. Most of those subsidiaries, including the subsidiary serving as the designated agent for making the allocations, are not subject to PUCT jurisdiction and are not even before the Court. Thus, relief cannot be fashioned for all the parties to the contract unless FERC exercises its jurisdiction. In addition, the issue turns on a highly specialized question of accounting — measurement of revenues for open energy contracts. It is not a pure question of law, but one on which there is already evidence introduced in the proceeding — evidence showing that the regulated entity followed regulatory guidance. It is within the special competence of FERC. Perhaps most important, there is an indisputable need for uniformity, lest each state seek an advantage for its retail customers by imposing a different interpretation of the tariff. This case falls directly within the regulatory responsibility of FERC.

Third, there is no reason to accept this case to investigate the use of primary jurisdiction case law when it would result in a similar resolution. In the end, petitioners appear to recognize that the issue raised here requires the uniform resolution that only FERC can provide. They make no attempt to argue that different allocations under the SIA should obtain in different states. Rather, they argue that "a state agency's improper refusal to refer an issue within FERC's special competence could be reversed." Petition at 14; *see also id.* at 18 ("In the event that a State proceeds without seeking necessary FERC review, that decision could be reversed."). It is hard to see what is gained by accepting review in this case to determine whether the Fifth Circuit should have called this an issue for FERC's primary jurisdiction rather than its exclusive jurisdiction.

It is easy to see, however, what is lost. The PUCT would inject needless confusion and delay into the ratemaking process as the parties litigate over whether particular issues of tariff interpretation would be within FERC's primary jurisdiction. Since utilities may have legal and practical difficulties imposing higher rates retroactively,[17] the delay jeopardizes their ability to obtain a reasonable return, even if their legal rights are ultimately vindicated.

The PUCT argues that it may consider interpretive issues concerning a multi-state tariff because "the ultimate availability of resort to this Court [is] sufficient to ensure the needed uniformity." Petition at 12. This is an utterly impractical solution. As the PUCT's own brief demonstrates, the electrical industry today conducts its business on a regional basis. Hundreds of multi-state tariffs underlie the wholesale markets for the sale and transmission of power. If every dispute requiring a uniform resolution were brought to this Court, this Court would have time for little else. FERC has the staff, the expertise and the statutory mission to perform this function. There is no point in accepting certiorari to establish some sort of parallel regime in state agencies and this Court.

II. The Decision Below Does Not Conflict With Decisions Of Other Courts

The petition does not attempt to demonstrate a conflict in the circuits. It cites no circuit that has reached a view contrary to the Fifth Circuit. Similarly, it cites no recent decisions of the state courts adopting an interpretation of this Court's decision in *Entergy* contrary to that of the Fifth

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[17] *State v. Pub. Util. Comm'n*, 883 S.W.2d 190, 198-99 (Tex. 1994) (retroactive ratemaking prohibited).

Circuit. In essence, it asks this Court to review a decision of a single court of appeals in splendid isolation.

On closer inspection, there are some other relevant decisions — which come out exactly the same way as the Fifth Circuit. The petition cites *Appalachian Power Co. v. Public Serv. Comm'n*, 812 F.2d 898 (4th Cir. 1987), which arose in the context of the same AEP multi-state system. There, the Public Service Commission of West Virginia, acting pursuant to a state statute, sought to examine the prudence of an apportionment agreement of transmission investment between utilities in the AEP system. *Id.* at 900-01. The Fourth Circuit rejected the West Virginia Commission's assertion of state statutory authority, holding that such authority was preempted by the FPA because FERC "has exclusive jurisdiction to consider the merits of the interstate agreement." *Id.* at 900. "Lodging exclusive authority in FERC to consider the merits of the [agreement] thus forecloses the potential for differing state pronouncements regarding an agreement involving utilities regulated by various states." *Id.* at 905.

Other circuits have relied upon the same fundamental principles. "Cases are legion affirming the exclusive character of FERC jurisdiction where it applies . . . ." *Public Utils. Comm'n v. FERC*, 900 F.2d 269, 274 (D.C. Cir. 1990) ("[I]f there be [FERC] jurisdiction over some component of the transaction, it is exclusive over that component."); *see also California ex rel. Lockyer v. Dynegy, Inc.*, 375 F.3d 831, 850-52 (9th Cir. 2004) ("[R]emedies for breach and non-performance of FERC approved operating agreements in the interstate wholesale electricity market fall within the exclusive domain of FERC."); *Transmission Agency of N. California v. Sierra Pac. Power Co.*, 295 F.3d 918, 929 (9th Cir. 2002) ("FERC has approved the construction and operation of the Alturas Intertie, and FERC alone (subject to court review of its final decision) can modify that decision,

or deal with any party who operates the Alturas Intertie improperly."); *Massachusetts Dep't of Pub. Utils. v. United States*, 729 F.2d 886, 888 (1st Cir. 1984) (Breyer, J.) ("Massachusetts' interpretation threatens confusion, possibly chaos. What is to prevent each state in a multistate service area from requiring the utility to file a *different* set of "reasonable" rate practices with FERC?").[18]

While these cases support the decision of the Fifth Circuit in this case, it is worth noting that there has been relatively little litigation of the same kind since this Court's decision in *Entergy*. The question presented here is not a frequently recurring issue in reported cases. Despite the participation of the National Association of Regulatory Utility Commissioners (representing 50 states), and the assistance of eight specific State Commissions, neither the PUCT nor these *amici* have been able to come forward with examples of cases in which this Court's decision in *Entergy* has been a stumbling block to the retail ratemaking process.

The absence of any precedent on the issues raised here cautions against any grant of certiorari at this time. Petitioners and their *amici* have argued, in essence, that, notwithstanding their obligations to their several subsidiaries, the holding companies will abuse their allocation authority by making arbitrary interpretations of their tariffs. That might be demonstrated — or disproved — through a large number of litigated cases. Petitioners and their *amici* have none. Petitioners also argue that state commissions can

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[18] *See also AEP Generating Co. & Ky. Power Co.*, 38 FERC ¶ 61,243, at 61,823 (1987) ("stat[ing] that the matters raised by [the utility] lie within our exclusive jurisdiction, insofar as they concern the allocation of costs and rates among the members of an integrated, interstate system.").

utilize the concept of primary jurisdiction to entrust more subtle issues to FERC, and can be subject to reversal in court for erroneous decisions. A series of agency and judicial decisions applying this doctrine would show its limits and consequences. Again, petitioners and their *amici* have none.

This case is also a poor vehicle to consider the issue raised in the petition because of the multiple changes in position and theory by the PUCT. The PUCT initially followed the recommendation of the ALJs who received the evidence and approved the method of accounting for revenues used by AEPSC. Resp. App. 18a. On rehearing, the PUCT changed its mind but failed to address the intervening decision in *Entergy*. In the district court and court of appeals, the PUCT acknowledged that FERC's jurisdiction was "exclusive" but argued that it was merely enforcing the plain language of the tariff. App. 16-17. In this Court, petitioners do not explicitly advance the plain language position but instead presented a theory of primary jurisdiction never presented below. Because primary jurisdiction was never addressed in either the administrative orders or in the decisions of the federal courts below, this proceeding does not furnish an appropriate record for analysis of that approach.[19]

Thus, apart from its other defects, the petition raises an issue that is not ripe for decision by this Court. The *Entergy* case was decided only four years ago. There has been relatively little litigation of the same kind in its wake, and no

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[19] Indeed, this case bears a striking resemblance to *Entergy*, in that the administrative agency here never discussed in the administrative record any reason for avoiding preemption other than its prudence powers — just as the state commission did in *Entergy*.

other reported decisions raising the particular issue decided here. The absence of a conflict is not only a weakness in the petition, but a loud warning that the issue here is not ready for review.

III. The Petition Raises No Issues of Exceptional Importance

The Petition should be denied for the further reason that it raises no issues of exceptional importance. The petition seeks to have this Court consider whether FERC's jurisdiction should be primary rather than exclusive when tariff interpretation issues arise in the context of a multi-state tariff. This issue was not even addressed in the proceeding below. The petition cites no other example of cases where the two approaches have been compared. It cites no secondary commentary identifying a problem in this area. There has been relatively little experience in applying this Court's decision in *Entergy*, and no cause for complaint.

The PUCT seeks to magnify the impact of the Fifth Circuit's decision by arguing that "Forty-two of the forty-eight contiguous States are served by subsidiaries of interstate public-utility holding companies." Petition at 7. This hardly helps, for it raises the obvious question of why the PUCT fails to present any cases of this kind from other jurisdictions. At the same time, it underlines precisely why the Commission must interpret the tariffs of these holding companies — because they typically operate in more than one state, and each state will have its own interests to protect. The exercise of jurisdiction by the Commission is essential to assure both impartiality and uniformity in interpretation of such tariffs.

The petition suggests that the decision of the Fifth Circuit might give the utilities too much leverage. The PUCT says that utilities might assert interpretive issues even when "the appropriate allocation was hardly disputable." Petition at 14.

This is an entirely hypothetical argument. The PUCT does not shown that *this* allocation was "hardly disputable." Nor could the PUCT advance that view. It initially found that the AEPSC correctly made the allocations under the SIA. App. 3. The PUCT also has conceded that "the SIA says nothing about the use of MTM accounting to value open transactions." App. 31. Thus, this case does not in any respect test the limits of FERC's exclusive jurisdiction. There is no cause for this Court to take up the question of FERC's jurisdiction to resolve a purely hypothetical problem regarding abuse of the administrative process not presented here.

The PUCT and its supporters argue that "if utilities adopt erroneous interpretation of their own tariffs, States might acquiesce in those interpretations rather than face the delays accompanying federal review." Petition at 9. The PUCT and its supporters present no evidence of that phenomenon. Nor does this allegation make much sense. Had the PUCT sought clarification from FERC when its administrative law judges first rejected its interpretation in 2003 (or before), it would certainly have obtained an answer long ago. Moreover, the procedure that it advocates — where (1) the state commission initially decides whether it should exercise jurisdiction; (2) a state or federal court then reviews that decision to determine whether FERC has primary jurisdiction; and (3) FERC then decides the substantive tariff interpretation issue — has the potential to create much longer systemic delays, arising from three layers of review.

In contrast, the Fifth Circuit's decision used a bright-line test. That bright-line test not only comports with the strict approach taken by this Court in *Entergy* and prior cases, but also minimizes delay by eliminating uncertainty. It would require the parties to go to FERC in every case where a question of allocation arises under a multi-state holding company tariff filed with FERC. The parties would know it.

The state agency would know it. There would be no reason to delay seeking a determination from the one institution with both the expertise and the mandate to give an authoritative answer. In the end, this would be a faster solution.

In fact, when there is disagreement over the meaning of a tariff, there need not be any delay in the state commission proceedings at all. A state regulator may proceed to final order in compliance with the federally-designated agent's allocation, yet make its order subject to whatever refunds FERC orders in the event FERC agrees with the state regulator's position. Accordingly, the state proceedings are not slowed down, the federal tariff does not get interpreted and enforced by a dozen different states with different interests, and the sky — instead of falling — stays firmly ensconced in the heavens.

The Fifth Circuit applied this Court's decision in *Entergy* in a straightforward fashion. There is no judicial experience showing that the issue is recurring or that the solution chosen is unworkable. The PUCT's effort to reframe the issue as one of primary jurisdiction, instead of exclusive jurisdiction, would contribute nothing on the facts of this case and would likely not be helpful in other cases. This Court need not expend its resources in analyzing an issue that does not even relate to a problem.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted,

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July 5, 2007

APPENDIX

SOAH DOCKET NO. 473-02-3169
PUC DOCKET NO. 26000

APPLICATION OF WEST TEXAS UTILITIES FOR AUTHORITY TO RECONCILE FUEL COSTS	§ § § §	**BEFORE THE STATE OFFICE OF ADMINISTRATIVE HEARINGS**

PROPOSAL FOR DECISION

I. Introduction

On June 3, 2002, West Texas Utilities Company (WTU),[1] a subsidiary of America Electric Power Company, Inc. (AEP), filed a petition for reconciliation of its eligible fuel expenses and revenues for the period from July 1,2000, to December 3, 2001. This represents WTU's final fuel reconciliation as an integrated utility ....

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X. AEP Energy Trading Activity

A. WTU's Evidence and Argument

WTU characterizes the crux of this issue as the proper treatment of financial margins from off-system transactions

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[1] Effective December 23, 2002, the legal name of WTU changed to AEP Texas North Company. As all testimony and pleadings reference WTU, this PFD will retain the name for ease of reference. WTU is now the deregulated power generating company.

that accrued to WTU because of its inclusion in the AEP family of electric operating companies. Sharing of such margins among the AEP companies is governed primarily by the CSW Operating Agreement and the broader System Integration Agreement (SIA), both of which have received approval from the Federal Energy Regulatory Commission (FERC).

[*43] Off-system transactions governed by the CSW Operating Agreement include those culminating in the actual delivery of electricity by one of the AEP West companies (including WTU). Margins produced by such transactions have been included in this proceeding in the same manner as in previous fuel reconciliations, according to WTU, and have not created serious controversy among the parties. However, the treatment of two other categories of off-system transactions has been controversial.

Those include transactions (initially governed by the AEP Interconnection Agreement) that resulted in the actual delivery of power by one of the AEP East operating companies. Margins from these transactions are shared among both AEP East and West companies under the terms of the SIA. During the reconciliation period, margins in this category allocated to WTU totaled $9,640,299.

In addition, the SIA governs a large number of energy trading transactions that did *not* culminate (at least for the most part) in the physical delivery of electricity. These represent instances in which trading produced commitments for an AEP company both to *buy* power from an unaffiliated entity and to *sell* a comparable block of power to that same entity, either directly or indirectly. Such offsetting commitments were resolved by determining the net difference between the sale and purchase prices and charging that amount of money to the

appropriate party an arrangement known as a "book out."[95] According to WTU, the overall financial loss or gain to AEP from these booked-out transactions represents a "margin" to be shared with WTU and credited against eligible fuel expenses (EFE) in this reconciliation process. However, during the reconciliation period, WTU recorded an overall *negative* margin for bookouts and similarly treated **[*44]** transactions. This produced combined margins (including those noted in the immediately preceding paragraph) of $3,957,902.[96]

* * *

[*46] With respect to another aspect of margin-calculating that produced controversy in this case, WTU defends the method for establishing the SIA's "Base Year" level of margins-which, in turn, governs, in part, the allocation among AEP companies of yearly margins for off-system transactions.[103] The Base Year level reflects historical margins for the period from July of 1999

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[95] WTU noted that a book out is not a prospective type of trade. It is a mechanism for resolving past transactions that avoids redundant deliveries of power. When any particular purchase or sale is made, the parties do not know if the transaction may eventually be booked out. By this reasoning, WTU rejected OPC's contentions that booked-out purchases are fixed non-energy costs that amount to payments to reserve capacity for future use.

[96] *See* OPC Ex. No. 22 at DSN-19.

[103] Under the SIA's tiered allocation system, the Base Year level defines the point separating the two tiers. Until margin amounts exceed this level, they are allocated between AEP East and AEP West companies on the ratio of pre-merger AEP East margins to pre-merger CSW margins.

through June of 2000. WTU contended that calculation of the Base Year level properly included the market values of "open positions"–that is, purchases or sales that had not been finally settled at the time of the calculation. During the Base Year and the reconciliation period, notes WTU, such treatment of open positions was an accepted industry practice. AEP recorded the value of open positions using the mark-to-market (MTM) methodology set out in contemporary guidance from the Financial Accounting Standards Board.

In response to a recommendation endorsed by all the other parties, WTU urged that nothing in the factual record would compel severing from this proceeding the consideration of AEP trading and marketing activity, in order to subject it to a Commission audit in a separate docket. According to WTU, evidence offered by other parties identified only one specific instance in which the allocation of margins among the AEP companies was alleged to violate the SIA–*i.e.*, Mr. Norwood's criticism of MTM accounting. WTU reiterates, however, that MTM accounting was consistent with contemporary accounting standards when AEP applied it. More fundamentally, though, WTU argues that because FERC has approved the SIA and its formula for allocating margins among the **[*47]** AEP companies, a Commission review of whether such wholesale transactions were reasonable would invade FERC's exclusive federal jurisdiction.

In other words, according to authority cited by WTU,[104] the SIA represents a tariff that is binding upon both AEP and the Commission. Because the SIA allocates margins among companies operating in 11 states, any adjustments to the allocations sought by one state could have detrimental impact

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[104] *Pacific Gas & Electric Co. v. Lynch*, 2002 U.S. Dist. LEXIS 13895, 13915 (N.D. Cal., 2002).

upon others. Under these circumstances, WTU argues, the courts have declared, "Only FERC has the objectivity and comprehensive overview that transcends. . . local concerns."[105] WTU therefore concludes that FERC is the only proper forum for efforts to adjust or check the accuracy of allocations under the SIA.

WTU urges in particular that parties seeking to change the proposed treatment of booked-out transactions in this proceeding were attempting to create a conflict with FERC-directed accounting. Similarly, WTU portrayed parties' efforts to examine the "prudence" of AEP's entering into the trading and marketing activities at issue in this case as a would-be infringement upon FERC's authority. The foremost judicial decision supporting this view is that of the U.S. Supreme Court in the *Mississippi Power & Light* case.[106] WTU also cited the Federal Fourth Circuit's decision in the *Appalachian Power Co.* case, which declared, "Because the prudence inquiry is inseparable from an inquiry into the [FERC-approved agreement's] justness and reasonableness," FERC and the state utility regulators would have to make identical inquiries regarding the agreement, "but from the perspective of different public interests." The court concluded, "Lodging exclusive authority in **[*48]** FERC to consider the merits of the [agreement] thus forecloses the potential for differing state pronouncements regarding an agreement involving utilities regulated by various states."[107]

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[105] *Appalachian Power Co. v. PSC of West Virginia*, 812 F2d 898, 905 (4th Cir. 1987).

[106] *Mississippi Power & Light Co. v. Mississippi ex. rel. Moore*, 487 U.S. 354 (1988).

[107] *Id.*

B. Other Parties' Evidence and Argument

As a threshold matter, Staff addresses WTU's contention that FERC has exclusive jurisdiction to review the allocation of margins under the SIA, ultimately concluding that this case has raised no questions to implicate issues of federal preemption. According to this view, Staff has not infringed upon FERC authority by challenging the terms of the SIA, the decision of AEP companies to enter the agreement, or the margin-sharing methodology set out in the SIA. Rather, Staff has simply questioned the eligibility of certain costs or margins for consideration in a specific reconciliation process defined by state law. Citing the U.S. Supreme Court's decision in *New Orleans Public Service, Inc. v. Council of the City of New Orleans*,[108] Staff asserts the Commission has authority to review the reasonableness and necessity of AEP energy trading and marketing and the propriety of passing through the costs of such activity to Texas consumers.

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C. ALJs' Summary and Recommendation

1. Jurisdiction

In their dispute over the Commission's jurisdiction in this case, the parties have entered a rather contused area of the law and have been unable to dispel much of that confusion. However, the ALJs believe that the Commission must have at least the authority to review the nature of the various categories of margins that WTU has proposed for consideration,

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[108] 491 U.S. 350 (1989).

in order to determine whether they fit within the regulatory framework of fuel reconciliation.

In the 1992 *Gulf States Utilities Co.* case,[117] a Texas court conceded the established principle that "[b]ecause FERC exercises exclusive jurisdiction to determine 'just and reasonable' rates for wholesale sales of electric power in interstate commerce ... federal preemption principles preclude state regulatory practices that effectively challenge the reasonableness of FERC-set rates." The court also noted, however, that FERC (in accord with the Federal Power Act) had long focused its authority upon the rates at which *sellers* marketed their power. By contrast, FERC had not reviewed market conditions or other factors to determine whether wholesale *purchasers* were prudent in contracting for power at the FERC-approved rates. That determination was left to subsequent state rate proceedings, according to a line of cases exemplified by *Pike County Light & Power* v. *Pennsylvania Public Utility Commission.*[118]

This established balance between the regulatory jurisdiction of FERC and the states came into question with the *Mississippi Power & Light* decision in 1988. The Supreme Court restrained the state of Mississippi from examining the prudence of one utility (MP&L) in obtaining power **[*54]** through a FERC-approved pooling agreement that allocated among several participating utilities the costs and output of the Grand Gulf nuclear power plant project. The state's action was invalid, the Supreme Court found, because the transactions it sought to

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[117] *Gulf States Utilities Co. v. Public Utility Commission of Texas,* 841 S.W. 2d 459, 464 (Tex. App. - Austin 1992, pet denied).

[118] 465A. 2d 735 (1983).

review "comprise the very System Agreements" that FERC had evaluated and approved in the exercise of its jurisdiction over wholesale rates.[119] Under the Grand Gulf pooling agreement, each utility was compelled to purchase the amount of power allocated to it. The Supreme Court thus concluded that MP&L was impermissibly "trapped" between FERC-mandated obligations and state refusal to allow it to recoup mandated expenses through retail rates.

In a case involving AEP that anticipated, to some degree, the *Mississippi Power & Light* decision, FERC declared the following:

> Transmission and allocation of the costs of the AEP [pool] transmission network are integral parts of the operation of the AEP pool. Therefore, the prudence of being a party to the. . . transmission agreement cannot be considered separately from the prudence of being a party to the entire AEP pool relationship.[120]

Taking into account these and other federal authorities, the Texas court in *Gulf States Utilities Co.* recognized that FERC has exclusive jurisdiction to evaluate agreements governing members of an integrated power pool. However, noting that preemption is a disfavored doctrine, the court found state review permissible if it "focuses solely on purchaser prudence, as *Pike County* permits a state regulatory commission to do" and if it "did not challenge FERC's wholesale rates by manipulating FERC-ordered allocations or second-guessing the

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[119] *Mississippi Power & Light* at p. 2431.

reasonableness of other factors previously approved by FERC."[121]

[*55] In briefing, the parties to this proceeding also discussed at some length the Supreme Court's *New Orleans Public Service, Inc.* decision,[122] which involved efforts by another utility (NOPSI) to recover allocated costs of the Grand Gulf project through retail rate proceedings governed by state law. The City Council of New Orleans refused to adopt rates that would cover all of such costs. In a resolution, the council announced that it would review NOPSI's rate request not upon the basis of the utility's prudence in initially entering the FERC-approved Grand Gulf pooling agreement, but rather upon its prudence in failing to diversify its power portfolio or to take other steps to protect ratepayers after the risks of investment in nuclear power became evident.

The Supreme Court examined this case from the perspective of whether the federal-court abstention doctrine should apply, not to address substantively the underlying question of whether FERC jurisdiction preempted the council's review of costs related to the Grand Gulf project. Still, the court made the following characterization of the council's order in the rate case:

> The Council has not sought directly to regulate interstate wholesale rates; nor has it questioned the validity of the FERC-prescribed allocation of power within the Grand Gulf System, or the FERC-prescribed wholesale rates; nor has it

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[121] *Gulf States Utilities Co.* at 469.

[122] *New Orleans Public Service, Inc. v. Council of the City of New Orleans*, 491 U.S. 350 (1989).

> reexamined the prudence of NOPSI's agreement to participate in Grand Gulf 1 in the first place. Rather, the Council maintains that it has examined the prudence of NOPSI's failure, after the risk of nuclear power became apparent, to diversify its supply portfolio. . . Nothing in this is directly or even indirectly foreclosed by the federal statute, the regulations implementing it, or the caselaw applying it.[123]

Upon remand of the case, the Fifth Circuit found no merit in *NOPSI*'s "facial preemption challenge" to the council's rate decision. The lower court based its conclusion largely upon its perception that the Supreme Court had implicitly rejected the view that "the Council could not regulate NOPSI's activities in this regard."[124] The lower court elaborated on the issue as follows: **[*56]**

> *Mississippi Power & Light* established that FERC had jurisdiction to determine whether the various utilities acted prudently in deciding to participate in the Grand Gulf venture. . . . The order before us presents a variation of that question. We must decide whether FERC has jurisdiction to determine whether NOPSI acted prudently once the Grand Gulf project was under way."[125]

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[123] *Id.* at 367.

[124] *New Orleans Public Service Co. v. Council of the City of New Orleans*, 911 F.2d 993, 1002 (5th Cir. 1990).

[125] *Id.* at 1001.

The court concluded that FERC had asserted no such jurisdiction to determine NOPSI's subsequent prudence in not acting to minimize losses, nor could it find any other basis for preempting the council's consideration of the issue.

The SIA at issue in this case resembles in some ways the pooling agreement at issue in the above-cited federal cases. It allocates rights and responsibilities arising from common or coordinated activities among a group of affiliated utilities. It defines pricing factors for exchanges of energy between the AEP East and West Zones. However, unlike the Grand Gulf agreement, the SIA does not require the signatory utilities to accept prescribed volumes of power at set prices. Moreover, the allocation "trading and marketing realizations"-which is the aspect of the SIA at issue in this case-is not clearly analogous to any aspect of the agreements or obligations discussed in decisions cited by the parties.

The allocation of such realizations or margins, as described in the SIA itself, appears to be quite generalized. The SIA prescribes only a division of margins between AEP East and West Zones, not the final distribution to the various operating companies within each zone. It defines a "Base Year Allocation"-*i.e.*, "the relative percentages of the total Trading and Marketing Realization from Off-System Sales . . . received by the AEP Operating Companies, on the one hand, and the CSW Operating Companies, on the other," during the 12 months preceding the effective date of the merger.[126] Margins up to the level achieved in the Base Year are allocated in accordance with the **[*57]** Base Year Allocation percentages. Margins in excess of that level are allocated according to the ratio of owned generating capacity

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[126] "System Integration Agreement," WTU Ex. No. 3 at WP/Schedule FR-7, 36 of 68.

in the two zones. The margins themselves are defined as "the difference between (i) revenues collected from Trading and Marketing Activities and (ii) the Out-of-Pocket Cost of such Trading and Marketing Activities and any transmission cost related to such activities"[127]-with a rather general definition of out-of-pocket costs also included. Few other details of the allocation process are included.

The ALJs have difficulty finding anything in the rather loose structure of the SIA that clearly precludes the Commission from reviewing the degree to which trading and marketing margins are properly examined in this reconciliation process. Certainly the SIA does not explicitly mandate any particular treatment of these margins by state regulatory agencies. Further, as WTU has acknowledged, these margins or realizations are not, per set eligible costs.[128] They are thus not, in normal perspective, burdens for which a utility would inevitably seek corresponding rate relief. While the SIA apparently obliges each AEP company to receive its share of these realizations, that hardly creates circumstances analogous to those that troubled the Supreme Court in *Mississippi Power & Light*–where a utility was perceived as trapped between the mandating of costs by one authority and refusal to recognize those costs by another. Here, the allocations are-or normally should be-financial gains for the participating utilities. Although state action requiring the partial return of such gains to the public would neutralize some benefits received by the companies such action would not, as in *Mississippi Power & Light*, compound already existing regulatory burdens upon them.

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[127] *Id.* at 41 of 68.

[128] *See* WTU's Reply Brief at 28.

Commission review of whether shared margins are properly presented in this case does not appear to interfere with the rather general and somewhat flexible purpose of the SIA, as expressed in the document's preamble: "The Parties desire to establish a framework under which the power **[*58]** supply resources of the AEP Operating Companies and the CSW Operating Companies will to the extent practicable be planned, operated, maintained and dispatched on a coordinated basis."[129] Indeed, Commission review (at least as sought by Staff) should not interfere even with the arguably tangential portions of the SIA that govern margin-sharing. A subsequent consideration of the proper regulatory treatment of allocated margins under state law does not affect the AEP companies ability to make the initial allocation of those margins as prescribed by the SIA,

Because the focus of parties' concerns in this case is not upon the propriety of the AEP companies' efforts to coordinate operations by initially entering the SIA, but rather upon the reasonableness and the proper treatment of energy transactions executed thereafter, the preemption issue here seems much the same as that described in the Fifth Circuit's *New Orleans Public Service, Inc.* decision: *i.e.*, once the SIA was in effect, did FERC assert continuing exclusive jurisdiction to determine whether the participating utilities acted prudently in all those transactions subject to accounting under the SIA? As did the Fifth Circuit, the ALJs find no evidence that FERC did so.

In summary, the anticipated Commission review of margin sharing would not seek to change wholesale rates or allocations of power prescribed by FERC, to scrutinize the prudence of WTU or its affiliates in entering the FERC-approved SIA, or to interfere with the functioning of mandatory provisions in any specialized pooling agreement such as that governing the Grand Gulf

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[129] WTU Ex. 3, SIA at 35 of 68.

project. Under these circumstances, the Commission is not preempted from examining, as appropriate, the prudence and reasonableness of transactions giving rise to any margins that may be applicable to determining state-administered rates. And, in the ALJs' view, a fundamental aspect of this inquiry into reasonableness is whether WTU has legitimately identified specific categories of transactions as subject to the SIA and the fuel reconciliation process. At the same time, this administrative process may not impinge upon FERC's jurisdiction by restructuring, elaborating upon, or second-guessing the reasonableness of the SIA's terms, as approved by FERC.

* * *

[*64]

4. Calculation of Base Year Margins

WTU submitted brief and somewhat conclusory evidence that its inclusion of the market values of 'open positions" and its use of MTM methodology in calculating Base Year margin levels was an accepted industry practice, supported by contemporary guidance from the Financial Accounting Standards Board, at the time the calculations were performed. Other parties assailed these methods in argument, but provided no actual evidence to rebut WTU's position. The record thus supports a finding that WTU adequately calculated the applicable Base Year margin levels.

* * *

[*91]

SIGNED AT AUSTIN, TEXAS, the 24th day of March, 2003

P.U.C. DOCKET NO. 26000
SOAH DOCKET NO. 473-02-3169

APPLICATION OF WEST TEXAS UTILITIES COMPANY FOR AUTHORITY TO RECONCILE FUEL COSTS	§ § § §	**PUBLIC UTILITY COMMISSION OF TEXAS**

ORDER

This Order addresses West Texas Utilities Company's (WTU's)[1] application for reconciliation of its fuel expenses and revenues for the period from July 1, 2000 through December 31, 2001. This is the final fuel reconciliation for WTU. Except as provided in this Order, the Public Utility Commission of Texas adopts the proposal for decision (PFD) and supplemental PFD, including findings of fact and conclusions of law, issued by the administrative law judges (ALJs) for the State Office of Administrative Hearings (SOAH) on March 24, 2003 and December 3, 2003, respectively. As discussed below, the Commission reverses the ALJs on the issues of the reconciliation period and the American Electric Power Company, Inc. (AEP) companies' trading activity. WTU's application, as modified by this Order, is approved.

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[1] Effective December 23, 2002, the legal name of WTU changed to AEP Texas North Company.

I. Background

On June 3, 2002, WTU filed its petition for reconciliation of its eligible fuel expenses and revenues pursuant to PURA[2] § 39.202(c) and P.U.C. SUBST. R. 25.236(g). This application represented WTU's final fuel reconciliation as an integrated utility providing service in the Electric Reliability Council of Texas (ERCOT) region. WTU [***2**] sought to recover $23,064,733,[3] plus $3,416,607 in interest, as its under-recovered eligible fuel costs for serving its customers in the ERCOT region.

For its Southwestern Power Pool (SPP) service area, WTU did not seek a final fuel reconciliation, because the Commission delayed implementation of retail competition in the SPP region.[4] WTU instead requested a surcharge to recover $680,776 in under-recovered costs, including $75,919 in interest, related to WTU's retail service in that area. In addition, WTU requested a good-cause exemption to P.U.C. SUBST. R. 25.236(e) to allow re-allocation of certain costs to all retail electric customer classes in its SPP service area.

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[2] Public Utility Regulatory Act, TEX. UTIL. CODE ANN. §§ 11.001-64.158 (Vernon 1998 & Supp. 2004) (PURA).

[3] This amount reflects ERCOT's final resettlement in February 2003 that reduces WTU's eligible fuel expenses by $1,681,032.

[4] Public Utility Commission of Texas Staff Petition to Determine Readiness for Retail Competition in the Portions of Texas Within the Southwest Power Pool, Docket No. 24468, Order on Rehearing (Feb. 1, 2002).

At its May 22, 2003 open meeting, the Commission adopted the PFD issued on March 24, 2003, with two modifications. The Commission reversed the ALJs on the issues of the reconciliation period and the AEP companies' trading activity and remanded those issues to SOAH for further evidence.[5] On December 3, 2003, the ALJs issued a supplemental PFD on the remanded issues. The Commission adopted the supplemental PFD with no changes.

* * *

III. Findings of Fact

* * *

[*12]

AEP Energy Trading Activity

49. The System Integration Agreement (SIA) approved by the Federal Energy Regulatory Commission (FERC) provides the contractual and federal regulatory basis for coordinated planning, operation, and maintenance of the power supply resources of the combined AEP/CSW system.

50. The SIA defines "trading and marketing activities" as all off-system sales and purchases, other than purchases used to serve native load, conducted on behalf of the operating companies of the combined AEP system.

51. The trading and marketing off-system purchase and sales transactions at issue in this proceeding were the result of arm's-length bargaining in the open market with unaffiliated entities.

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[5] *See* Order on Remand at 1 (May 28, 2003).

52. The SIA effectively defines the margins produced by these trading and marketing activities to be the difference between the revenue generated by off-system sales **[*13]** and the out-of-pocket costs of such sales. The SIA defines out-of-pocket costs broadly to include all expenses incurred that would not otherwise have been incurred if the corresponding service bad not been arranged.

53. WTU has correctly calculated and properly credited margins produced by AEP's trading and marketing activities to WTU's customers in accordance with the SIA.

* * *

[*20]

V. Ordering Paragraphs

In accordance with these findings of fact and conclusion of law, the Commission issues the following order:

1. As modified by this Order, the Commission grants the application of WTU (now known as AEP Texas North Company) for reconciliation of fuel revenues and expenses for the period July 1, 2000, through the day before the date customer choice began as defined in this Order.

2. In order to implement a surcharge for the fuel balances attributable to sales made in the SPP service territory, AEP Texas North Company shall establish the balances by retail rate class as of December 31, 2001, in compliance with this order. AEP Texas North Company shall file a revised SPP surcharge tariff sheet in Tariff

Control No. 27550, entitled *Compliance Calculations Pursuant to Final Order in PUC Docket No. 26000.* This filing shall include a transmittal letter stating that the calculations attached are in compliance with this order. The **[*21]** timetable for review of the compliance filing shall be established by the Commission ALJ assigned to the tariff.

3. Pursuant to PURA § 39.202(c), WTU, now known as AEP Texas North Company, shall include the cumulative under-recovery balance associated with retail service provided within ERCOT as part of the final true-up proceeding under PURA § 39.262.

4. All motions or requests for entry of specific findings of fact and conclusions of law and any other requests for general or specific relief, if not expressly granted herein, are hereby denied.

SIGNED AT AUSTIN, TEXAS the 1st day of March 2004

P.U.C. DOCKET NO. 26000
SOAH DOCKET NO. 473-02-3169

APPLICATION OF WEST TEXAS UTILITIES COMPANY FOR AUTHORITY TO RECONCILE FUEL COSTS	§ § § §	**PUBLIC UTILITY COMMISSION OF TEXAS**

SECOND ORDER ON REMAND

At its May 13, 2004 open meeting, the Public Utility Commission of Texas granted the intervening parties'[1] motion for rehearing on West Texas Utilities' (WTU's)[2] inclusion of the value of "open transactions" in calculating base-year energy-trading margins. Specifically, the Commission found that WTU's affiliate American Electric Power Service Company (AEPSC) inappropriately included the "mark-to-market" based value of open transactions in determining the energy-trading margins contributed by the AEP East operating companies in the base year of July 1, 1999-June 30, 2000. Consequently, the combined AEP East and West companies' base-year margins total was inflated by approximately $84.2 million. As a result of that inflation, AEPSC improperly allocated margins generated in the reconciliation period.

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[1] These parties are the Office of Public Utility Counsel and the Cities of Abilene, Ballinger, Cisco, San Angelo, and Vernon.

[2] WTU is now known as AEP Texas North Company.

The Commission also found that there is insufficient evidence in the record to establish with confidence the dollar impact of the above ruling on WTU's final fuel-expense balance. Therefore, the Commission remands this matter to the State Office of Administrative Hearings for determining that impact.

[*2]

SIGNED AT AUSTIN, TEXAS the 20th day of May 2004

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(7)

No. 06-1438

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SUPREME COURT, U.S.

In the Supreme Court of the United States

PAUL HUDSON, *ET AL.*,
Petitioners,

v.

AEP TEXAS NORTH COMPANY, *ET AL.*,
Respondents.

On Petition for Writ of Certiorari to the
United States Court of Appeals for the Fifth Circuit

PETITIONERS' REPLY

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PETITIONERS' REPLY

I. The Decision Below Threatens the Established Regulatory Framework and Warrants Immediate Review.

Petitioners seek review because the court of appeals decided an important question of federal law that the Court has not yet resolved. *See* Sup. Ct. R. 10(c). Whether States may interpret Federal Energy Regulatory Commission tariffs when setting retail rates is the very question that the Court reserved in *Entergy Louisiana, Inc. v. Louisiana Public Service Commission*, 539 U.S. 39 (2003). Because this matter is of critical importance to the proper functioning of the national electric system, the Court should grant the petition to establish a clear rule.

That other circuits have not specifically considered whether a state commission may interpret a FERC tariff contrary to the utility's interpretation does not diminish the significance of the issue. As in *Nantahala Power & Light Co. v. Thornburg*, 476 U.S. 953 (1986), *Mississippi Power & Light Co. v. Mississippi ex rel. Moore*, 487 U.S. 354 (1988), and *Entergy*—cases in which this Court recognized no circuit split—the present dispute raises an important question of the proper role of state commissions in a dually regulated federal-state system. And like the lower court decisions reviewed in each of those cases, the Fifth Circuit's opinion in the case below introduces considerable uncertainty into the state rate-setting process.

Indeed, the confusion wrought by the Fifth Circuit's opinion prompted the National Association of Regulatory Utility Commissioners and a number of individual state commissions (including those of the other two most populous States—New York and California) to request clarification of the appropriate rule in this case. *See* NARUC Br. 1-5. Understandably, States

throughout the nation have grave concerns about a ruling that gives utilities the upper hand in their retail rate proceedings.

As with both *MP&L* and *Entergy*, the national import of the question presented is readily apparent because it concerns the proper construction of state authority to regulate subsidiaries of holding companies that operate in multiple States. The Solicitor General noted the prevalence of such interstate arrangements when he successfully urged the Court to grant the *Entergy* petition. Br. of Amicus Curiae United States at 17, 539 U.S. 39 (2003) (No. 02-299). Not only are the very same interstate concerns implicated here, but the underlying facts in this case are more common than those in *Entergy*. FERC prescribes a specific method of allocation much more often than it delegates allocation discretion to an agent.

AEP Texas North Company (TNC) incorrectly claims that other courts of appeals have "come out exactly the same way as the Fifth Circuit." TNC Resp't Br. at 21. The decisions that TNC cites do not stand for the principle that FERC has exclusive jurisdiction over *all* tariff matters; they recognize only that FERC's authority to *set rates* is exclusive.[1]

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1. *See also Appalachian Power v. Pub. Serv. Comm'n of W. Va.*, 812 F.2d 898 (4th Cir. 1987) (finding that whether the utility was prudent to enter into the wholesale power agreement was a question within FERC's exclusive jurisdiction); *Pub. Util. Comm'n of Cal. v. FERC*, 462 F.3d 1027 (9th Cir. 2006) (deciding whether FERC or the State had authority over a certain segment of pipe; unrelated to rate setting); *Cal. ex rel. Lockyer v. Dynegy, Inc.*, 375 F.3d 831, 853 n.25 (9th Cir. 2004) (finding that California sought "to alter the terms and conditions provided for in the tariff"); *Transmission Agency of N. Cal. v. Sierra Pac. Power Co.*, 295 F.3d 918, 930 (9th Cir. 2002) (finding the suit for damages preempted because it "assum[ed] a hypothetical rate different from that actually set by FERC").

FERC itself has confirmed this point: The agency has explicitly disclaimed exclusive authority to interpret its own tariffs. *See Constellation Energy Commodities Group, Inc.*, 119 FERC ¶ 61,292, 2007 WL 1791169, at *7 (June 21, 2007) (holding that "[c]onstruing contractual and settlement agreement provisions and inquiring into the parties' intent are straightforward matters of contract interpretation" that do not warrant FERC review); *City of Glendale, Cal. v. Portland General Elec. Co.*, 115 FERC ¶ 61,231, 61,847-48 (2006) (ruling that state court claim seeking only to enforce the filed rate, not to alter it, did not require exercise of FERC jurisdiction); *Kentucky Utils. Co.*, 110 FERC ¶ 61,285, 62,102-03 (2005) (holding that state court suit that "only seeks enforcement of an existing [FERC-filed] contract, and not the setting of a new just and reasonable rate . . . does not fall within the Commission's exclusive jurisdiction").

TNC also reaches to recast the question presented as an issue about FERC's primary jurisdiction and then to argue waiver by the PUCT for not raising the ground below. The PUCT did not waive any primary-jurisdiction issue because there is no such issue. The petition discusses this doctrine only to show that, in those rare cases in which interpreting a FERC tariff requires referral to FERC, access to FERC is available as part of a court's review of a state agency's decision. The issue in this case is—and has always been—whether federal law preempts a State from interpreting a FERC tariff to insure that the filed rate is used to set retail rates.

II. The Decision Below Jeopardizes the Ability of States to Make Timely and Impartial Adjustments to Retail Rates.

TNC claims that there will be no harm or delay if the PUCT sets retail rates subject to any subsequent FERC decision. But

when TNC erroneously interprets its tariff, TNC's ratepayers will have to pay unreasonable rates until and unless FERC decides the case. TNC's "solution" means that the utility always prevails, at least in the short term.

But with state interpretation of the FERC tariff, an independent agency makes the decision. TNC improperly assumes that States will abuse their discretion in deciding these issues. Instead, the PUCT is created "to assure rates, operations, and services that are just and reasonable to the consumers and to the utilities." Tex. Util. Code Ann. § 11.002(a) (Vernon 2007). And this Court has recognized that state agencies must be presumed to be evenhanded. *See Withrow v. Larkin*, 421 U.S. 35, 53 (1975) ("Without a showing to the contrary, state administrators 'are assumed to be men of conscience and intellectual discipline, capable of judging a particular controversy fairly on the basis of its own circumstances.'" (quoting *United States v. Morgan*, 313 U.S. 409, 421 (1941))). In contrast, the utility—a for-profit company—has no mandate to balance the competing claims of utilities and ratepayers. Instead, utilities have a natural incentive to interpret tariffs to their benefit. *See United States v. Falstaff Brewing Corp.*, 410 U.S. 526, 568 (1972) ("[A]bsent special circumstances, [corporations] can be expected to follow courses of action most likely to maximize profits.").

According to TNC, *Entergy* means that the utility must prevail. But that assertion relies on a radical interpretation of this Court's opinion, reasoning that the mere fact that a utility is tasked with implementing a tariff (i.e., performing the required calculations) grants the utility discretion to interpret the tariff any way it sees fit. Resp't Br. at 16. That interpretation stands in stark contrast to the Court's decision. In *Entergy*, the FERC tariff had left one factor, whether certain mothballed generators were available for service, dependent on

the utility's discretion. 539 U.S. at 49. TNC unreasonably stretches this Court's recognition of FERC's express grant of discretion to the utility in *Entergy* into a rule of unlimited utility discretion to revise a tariff's meaning.

TNC's claim that, if the PUCT errs, the utility will be unable to recover the rates the PUCT should have set is groundless. Should a court reviewing the PUCT's order find error, it can be corrected by the PUCT on remand. *See Southwestern Bell Tel. Co. v. Pub. Util. Comm'n of Tex.*, 615 S.W.2d 947, 954 (Tex. App.—Austin 1981), *writ ref'd n.r.e.* 622 S.W.2d 82 (Tex. 1981) (per curiam).

III. The PUCT Was Not Preempted, Because It Only Interpreted a Tariff; It Did Not Set Rates.

TNC ignores the qualitative differences between setting rates and interpreting a tariff. Courts recognize these differences by characterizing rate setting as legislative and tariff interpretation as judicial. *See Great Northern Ry. Co. v. Merchants' Elevator Co.*, 259 U.S. 285, 290-91 (1922). The legislative nature of rate setting means that neither state agencies nor courts can set interstate wholesale electric rates. The judicial nature of construing the tariffs that set rates means that both state agencies and courts can interpret tariffs.

"The rate-making power is a legislative power and necessarily implies a range of legislative discretion." *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 313 (1989) (citing *Simpson v. Shepard*, 230 U.S. 352, 433 (1913)). Courts, having no authority to choose one correct rate within the range of reasonable rates, cannot set rates. An agency authorized to set rates can choose within the range, and, once it sets the rate, that becomes the only legal rate. *Montana-Dakota Util. Co. v. Northwestern Pub. Serv. Co.*, 341 U.S. 246 (1951) (holding

courts can assume no right to a rate other than the one set by FERC).

State agencies cannot set interstate wholesale electric rates. If they could, different States, choosing within the permissible range, could set different rates for the same interstate wholesale transaction.

Thus, regarding authority to set rates, a bright line indeed separates courts from federal agencies and state agencies from federal agencies.

But no bright line separates federal agencies from courts and state agencies when interpreting a federal tariff. The Federal Power Act expressly grants federal courts authority to enforce FERC tariffs. 16 U.S.C. § 825p (2000). State courts also have jurisdiction to interpret federal tariffs. *See, e.g.*, *Pan Am. Petroleum Corp. v. Superior Court of Del.*, 366 U.S. 656, 666 (1961).

TNC ignores the distinction between rate setting and tariff interpretation, claiming that FERC must have exclusive jurisdiction over *all* tariff-related matters. But this Court and circuit courts have repeatedly recognized that the authority to interpret tariffs is not limited to federal agencies. In *Great Northern Railway*, the Court recognized that a court's task in enforcing the filed rate "is to determine the meaning of words of the tariff which were used in their ordinary sense and to apply that meaning to the undisputed facts." 259 U.S. at 294. Therefore, preliminary resort to the federal agency was unnecessary. *Id.* This principle still applies. *See Brown v. MCI WorldCom Network Servs., Inc.*, 277 F.3d 1166, 1171-72 (9th Cir. 2002).

As its final order demonstrated, the PUCT only interpreted the filed rate. Findings of Fact 89-95 in that order reveal a step-

by-step analysis of the wording of the FERC tariff to determine which off-system sales were included in the FERC-tariff formula. Pet. App. 33-35. That is not rate setting, which would be preempted. Instead, it is the type of analysis courts use to interpret a contract or a tariff. Although the PUCT is a state agency rather than a court, the same principle applies. Because state courts can interpret federal tariffs, it cannot be argued that federal agencies have exclusive authority to interpret those tariffs. TNC has provided no other principle that would justify proscribing state agency application of federal tariffs.

The Court has recognized that judicial review ensures necessary uniformity of interpretation. *See Great Northern*, 259 U.S. at 290-91. That fact defeats TNC's argument that allowing state agencies to interpret FERC tariffs could lead to different interpretations of the same FERC tariff by different States. Only one rate is set by the tariff, and the agency's duty to comply with federal law, coupled with the protections of judicial review provide a sufficient safeguard against conflicting interpretations of the same tariff.

TNC also relies on a FERC decision quoted in a concurrence by Justice Scalia to claim that state agencies cannot interpret tariffs. *AEP Generating, Inc.*, 36 FERC ¶ 61,226 (1986), *quoted in MP&L*, 487 U.S. at 378 (Scalia, J., concurring). But neither the concurrence nor the agency order turned on state-agency authority to interpret tariffs. Justice Scalia's concurrence addressed FERC's authority to make a prudence decision about a utility's participation in a nuclear power plant and purchase of power from that generator. Likewise, *AEP Generating* concerns a utility entering into joint ownership of a generator and "the justness and reasonableness of the unit power sales arrangement . . . ." 36 FERC at ¶ 61,550.

Neither the *MP&L* concurrence nor the quoted FERC order decided that only FERC may interpret its tariffs. Nor do the other cases TNC cites concern the interpretation of a federal tariff. Contrary to TNC's claims, *Nantahala*, *MP&L*, and *Entergy* do not answer the question in this case. Instead, each recognizes that once FERC has set rates, States *must* comply with the FERC tariff. That is what the PUCT attempted to do here.

TNC also argues that state-agency review of FERC tariffs could trap TNC's costs. That misapprehends the nature of trapping, which occurs when a state commission prevents the utility from recovering its FERC-approved rate. *MP&L*, 487 U.S. at 372 (quoting *Nantahala*, 476 U.S. at 970) ("When FERC sets a rate between a seller of power and a wholesaler-as-buyer, a State may not exercise its undoubted jurisdiction over retail sales to prevent the wholesaler-as-seller from recovering the costs of paying the FERC-approved rate . . . ."). By definition, when a State requires that the utility recover its FERC-approved rate, no trapping is involved. The utility is responsible to correctly follow the FERC-approved rate in all States. Its failure to charge the filed rate in one State does not allow the utility to overcharge in a different State, claiming trapping.

CONCLUSION

The Court should grant the petition for writ of certiorari.

Respectfully submitted,

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